LOAN 656-BR

RESTRICTED

Report No. DB-52a

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL DEVELOPMENT ASSOCIATION

APPRAISAL OF BANCO DO NORDESTE DO BRASIL S.A.

December 19, 1969

Development Finance Companies Department

CURRENCY EQUIVALENTS

Currency unit: Novo Cruzeiro (New Cruzeiro)

Average 1968 Exchange Rate:

U.S.$ 1.00	=	NCr$ 3.396
U.S.$ 1 million	=	NCr$ 3,396,000
NCr$ 1 million	=	U.S.$ 294,464

Exchange Rate Effective December 31, 1968:

U.S.$ 1.00	=	NCr$ 3.830

Exchange Rate Effective October 3, 1969:

U.S.$ 1.00	=	NCr$ 4.210

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SUMMARY

i. Banco do Nordeste do Brasil S.A. (BNB) was established in 1954 by the Federal Government of Brazil to contribute to the economic development of the Northeast of the country.

ii. The Brazilian Northeast, which contains over 27 million inhabitants or 29% of the country's population, has lagged far behind the rest of the country in its economic development. Northeastern agriculture is endangered by severe droughts which have occurred in the past about once every ten years. To attract investment capital from the rest of the country into Northeastern industry and agriculture, the Federal and State Governments have devised several incentives, among them a tax credit scheme (the "34/18 scheme") under which Brazilian firms can deduct 50% of their income tax liability for investments in the Northeast. This scheme has considerably stimulated industrial investment in the region. Distortions due to the prevalence of negative interest rates for industrial loans will be attenuated by the introduction, in January 1970, of a new pattern of interest rates for long- and medium-term industrial financing by the national development banks.

iii. BNB is an official multi-purpose institution financing investment in agriculture as well as in private industry and in certain public utilities. Moreover, it is a full-fledged commercial bank, making short-term loans and discounting commercial paper. A large part of its resources consists of special deposits generated under the tax credit scheme, at average maturities of 12 to 18 months. Other resources are provided by loans from the Inter-American Development Bank, demand and term deposits from the public, and rediscount facilities with the central bank.

iv. BNB's total loan and discount portfolio increased from NCr$ 351.2 million (at 1968 prices) in 1965 to NCr$ 869 million in 1968. As of June 30, 1969, 35% of its portfolio was at short-term, 11% at medium-term (six months to two years) and 54% at long-term (over two years). Investment loans to private industry accounted for 21% of total loans, while agricultural finance was 31% of the total.

v. Total assets increased from NCr$ 653.6 million in 1965 (at 1968 prices) to NCr$ 1,237.6 million in 1968, in spite of the fact that BNB's local currency loans have not been subject to monetary correction and are therefore exposed to erosion by inflation. Equity grew from NCr$ 34.8 million (at 1968 prices) to NCr$ 199.2 million during the same period. Seventy-eight per cent of the increase in equity was derived from retained earnings.

vi. BNB has a staff of more than 3,500 distributed among its head office and 67 branches covering the Northeast region. It is well-organized and capably managed, and has a generally satisfactory record of performance.

vii. BNB is presently facing a shortage of long-term resources. It has requested a Bank loan of US$ 25 million to provide it with foreign currency resources to cover the import component of industrial investment financing. On the local currency side, most of BNB's resources are at short- and medium-term and liquidity considerations make it impossible to employ more than a small part of them in longer-term lending. The additional resources which BNB hopes to attract during the coming years should be sufficient to satisfy the justified needs for long-term funds of its clientele. However, to assure the availability of sufficient long-term cruzeiro resources to complement the foreign currency resources which would be made available by the Bank, it was agreed during negotiations that BNB should make arrangements to draw on supplementary resources to the extent necessary to enable it to carry out an industrial investment lending program of at least NCr$ 100 million each during 1970 and 1971 in the event the institution's ordinary resources fall short of expectations.

viii. BNB continues to lend at negative interest rates and below its own cost in its agricultural lending program and consequently depends on leverage with non-indexed, low cost funds and on other lending programs to operate profitably. To avoid a possible erosion of its equity, it was agreed during negotiations that BNB would take appropriate action whenever BNB's return on equity (in real terms) drops below a rate of 5%. BNB also gave a similar undertaking concerning the return on capital employed in its industrial lending, which should not drop below a rate equal to the Bank's lending rate on the proposed loan, which will be 7%.

ix. BNB is a suitable and creditworthy borrower. The proposed loan of US$ 25 million would cover its foreign exchange requirements for financing of the import component of private industrial projects during a period of around 18 months. Its terms should be similar to those normally applied to loans to development finance companies, including the standard commitment charge. Additionally, the following specific points were agreed upon during negotiations:

a. BNB will at all times apply to its operations a formula, acceptable to the Bank, defining its minimum liquidity requirements;

b. BNB's total indebtedness will be limited to ten times the amount of its unimpaired equity; however, total outstanding term debt (with initial maturities of more than one year) will not exceed four times its unimpaired equity;

c. the proceeds of a Bank loan will be relent at a rate of at least 2.5% above the rate charged by the Bank;

d. the Bank's prior approval will be required for all projects using more than US$ 250,000 from the loan; however, the aggregate free limit for sub-loans not requiring the Bank's prior approval will be US$ 5 million;

e. BNB will have its accounts audited annually by a qualified independent auditor acceptable to the Bank, and submission of a report on the first audit made, disclosing a satisfactory financial position of the institution, will be a condition of effectiveness of the proposed loan.

APPRAISAL OF

BANCO DO NORDESTE DO BRASIL S.A.

I. INTRODUCTION

1. Banco do Nordeste do Brasil (BNB) has requested a Bank loan to finance its foreign currency lending to private industry in the Northeast of Brazil. A mission consisting of Messrs. García-Rayneri, Helling, and Hughes, of the Bank, and Mr. M. Lord of IFC, appraised BNB in April/May 1969. Their findings and recommendations are contained in this report and its annexes. The report is supplemented by a Report on the industrialization program in the Northeast of Brazil written by the industrial policies group of a recent Bank economic mission to Brazil (the "Supplementary Report"), with special emphasis on the activities of the Superintendency for the Development of the Northeast (SUDENE) and on the various incentives available for industrial projects.

II. THE ENVIRONMENT

General

2. The Northeast of Brazil includes the states of Piaui, Ceara, Rio Grande do Norte, Paraiba, Pernambuco, Alagoas, Sergipe, Bahia, and part of the state of Maranhao. The limits established as the area of operations of Banco do Nordeste do Brasil include not only the area traditionally known as the Northeast, but also the entire state of Maranhao, as well as the northern part of Minas Gerais. Over 27 million inhabitants live in this area of 1.5 million square kilometers; that is, 29% of the country's population lives in 17.6% of the area. The number of persons per square kilometer varies from 5 in Piaui to 42 in Pernambuco. Annual per capita income in the Northeast in 1968 was around US$ 200 and in Brazil as a whole, US$305. The Northeast is an area in which topography and climate have combined to produce three distinct climatic zones: (a) the coastal "zona de mata", which is hot and tropical and contains the region's major cities; (b) the "agreste" or intermediate zone, which has a milder climate, and in which food crops are grown on a large scale; and (c) the "sertao" which makes up the vast portion of the region and which is a semi-arid land populated by farmers and ranchers.

3. The "sertao" suffers the greatest extremes of climate. An amount of rain averaging about 27 inches falls over a period of several months. If the rainy season begins too late, if it is shorter than usual or if the rains are meager, then water resources may be insufficient to provide for the rest of the year, and drought may result. In addition, the equatorial location of this area gives rise to a high evaporation rate and water must be strictly conserved to provide for the months of the dry season. In the catastrophic drought of 1877-79, 50% of the population of the Northeast died of a combination of thirst, starvation, or disease,

and public concern pushed the Government to create an "Inspetoria" for the Northeast to deal with the problem of drought. This was the initial step in a pattern of institution-building which followed almost every subsequent severe drought. The focus until the middle of this century was an engineering one; that is, a solution to the recurring droughts (about one every ten years) was seen in the building of dams and reservoirs to contain water, and of roads to enable the unfortunate inhabitants to escape the area. The severity of the drought of 1950 clearly revealed the failure of this approach to solve the problem, and a more integrated approach was sought: one that would promote the economic development of the region in general rather than concentrate narrowly on the fight against the effects of the droughts. The creation of Banco do Nordeste do Brasil (BNB) was seen as an answer to this need. Another drought in 1958 was the impetus behind the creation of the Superintendency for the Development of the Northeast (SUDENE).

4. Industrialization of the Northeast has lagged far behind the national average. Between 1949 and 1958, the Northeast's share in manufacturing output fell from 10.1% to 6.9%, and its share in manufacturing employment, from 16.7% to 11.0%. In 1960, industry (including mining, construction and utilities as well as manufacturing) accounted for only 11% of regional income, as compared to 26% for Brazil as a whole.

5. The wide gap between economic development in the region and in the rest of the country, combined with a growing social and political unrest and the phenomenon of the periodical droughts, underlie recent Government policy for the Northeast.

SUDENE and the 34/18 Tax Credit Scheme

6. Starting after the severe drought of 1958, the Federal Government created SUDENE as its principal instrument in the development of the region. The new agency was granted broad authority to supplement and control the activities of existing regional agencies. Besides infrastructure investments in the public sector, which are carried out directly by SUDENE from funds stemming from the Federal budget, the agency also administers important incentives to private investment in the field of income tax and customs duty exemptions for industries. Since 1961, these incentives comprise a particularly powerful scheme known as the "34/18 scheme".

7. The 34/18 scheme, which derives its name from two articles of the Federal Laws approving SUDENE's Master Plans for 1961 and for 1963-1965 respectively, is a tax credit system under which corporations throughout Brazil may discount up to 50% of their corporate income tax liability for investment in new or existing agricultural, industrial and telecommunications projects in the Northeast approved by SUDENE. Pending SUDENE's approval these tax credit funds are deposited in non-interest bearing

accounts with BNB. Until recently, there was a period of three years during which the depositor had to choose a project for investment and notify SUDENE of his intention; in March 1969, this period was reduced to one year. Normally, the tax credit has to be invested in equity, but under certain circumstances investment in loans to Northeastern companies is also possible. Similar schemes exist for the Amazon region and for priority sectors such as fishing, reforestation and tourism.

8. SUDENE uses a point system in determining the degree of priority of projects submitted for approval. Points are awarded according to plant location, essentiality, use of regional inputs, import substitution, broad-based ownership, labor absorption and labor participation in profits. Depending on priority as indicated by the points attributed to a project by SUDENE, 34/18 tax credits may be used up to 75%, 60%, 50%, 40%, or 30% of the project's total non-loan financing.

9. The aggregate total of deposits made for investments in the Northeast under the 34/18 scheme from its inception in 1962 through 1968 was NCr$ 1,234.5 million at current prices (NCr$ 1,831.2 million at 1968 prices). During the early years of the scheme, SUDENE's project approvals lagged behind the inflow of deposits but since 1967 the volume of approvals has grown at a quicker rate than the volume of inflowing deposits, so that aggregate approvals exceeded deposits at the end of 1968. Actual disbursements under approved investment projects were NCr$ 556.1 million at current prices (NCr$ 646.2 million at 1968 prices) at the end of 1968. The Supplementary Report contains detailed information on the industrial sectors, geographic location, number of jobs created and marketing patterns of the SUDENE-approved projects. Industrial projects approved by SUDENE through 1968 are expected to result in an annual average growth in gross value added by manufacturing industries in the Northeast of 9.3% from 1965 to 1973, compared to a rate of 7.8% for the period 1955-1965. Employment created by the projects approved by SUDENE until the end of 1968 is anticipated to be around 112,000 with an average investment per worker of around US$7,500. The anticipated average ratio of profits of these projects is 25.4% on sales and 32.3% on total capital invested.

Financing of Industrial Investment

10. 34/18 funds account for approximately 45% of total investment in projects approved by SUDENE during 1966-1968. Free resources of the sponsors contribute some 22%, while external financing makes up 15% and local currency loans from official banks (BNB and BNDE [1]) 18% of total investment cost. It should be noted that this pattern of financing has been determined from the financing plans in SUDENE's appraisals, i.e., at a stage prior to finalizing the financing arrangements for the projects. Considering that BNB and BNDE are free to reject loan applications, the

1/ BNDE stands for Banco Nacional do Desenvolvimento Economico, which is Brazil's nationwide official development bank.

actual share of free resources of the sponsors is likely to be somewhat higher, and the loan financing from official banks somewhat lower than indicated above.

11. Term loan financing is provided exclusively by Government financial institutions, mainly BNB and BNDE. While BNB addresses itself mainly to medium-sized industry and, through State development banks, to small industry, BNDE only lends to big projects requiring loans of NCr$ 10 million and more. Thus, while BNDE's share in total bank financing is not negligible in volume (approximately 25-30%), it has made relatively few loans and, for the average investor, BNB is the only local source of loan financing.

Evaluation of the Industrialization Program

12. The industrial incentives program for the Northeast has been and continues to be highly successful in mobilizing and transferring resources to the region and in committing these resources to investment in manufacturing industry. It has helped regional industry to become more diversified and contributed to reduce the traditional disparity of income between the Northeast and the rest of Brazil. Anticipated profitability of new industrial projects appears to be very satisfactory.

13. The incentives system appears to be very generous, so that the question arose whether, after the relatively good start of the industrialization program, it might not be appropriate to introduce some modifications that would result in a reduction and refinement of some of the incentives. The Supplementary Report suggests several steps in this connection (see page 16, paragraph 55 of the attached report). These were discussed with the Brazilian Government during negotiations. The Government, however, did not want at present to modify the SUDENE scheme as a whole because this would involve parallel modifications of the rest of Brazil's regional and sectoral incentive schemes which were held to be inopportune for the time being. The appropriateness and effectiveness of the industrial incentives system needs the continuing attention of the Government. Meanwhile, BNB has affirmed that it will seek to assure the highest possible proportion of non-34/18 equity funds in the financing of the projects to which it makes loans and that it will not submit for Bank financing, except in special circumstances, projects in which non-34/18 funds account for less than 25% of total estimated investment cost. And the Government has accepted the principle that interest rates should be positive; the National Monetary Council, in its meeting of September 19, 1969, adopted a new interest rate structure applicable to lending operations of the financial institutions controlled by the Federal Government. The new rules, which will come into force on January 1, 1970, provide for loans of up to 60 months to carry interest at 12% p.a., plus a fixed monetary correction of 10% p.a. Loans of more than 60 months will be made at rates of between 4% and 12% plus a full indexing of the principal. (BNB intends to charge 10% on the indexed principal.) While this is not wholly satisfactory, it is a step in the right direction.

Inflation and Its Effects on Industrial Lending

14. The inflation of the Brazilian currency has created special problems for the industrial sector in Brazil. Inflation was generally kept within annual rates of around 15-30% during the 1950s; but during the early 1960s, the General Price Index soared to rates of 51.7% (1962), 73.7% (1963) and 90.8% (1964). Since then, the rate came down again to 28.6% during 1967 and 24.2% during 1968, and may be expected to further decrease in the future.

15. Since 1964, the price level of manufactured goods normally has risen faster than the level of raw material prices and wages, so that industrial enterprises on the whole benefited from the inflation. However, access to borrowings, both at short term for working capital financing and at longer term for investment finance, is difficult because of the very limited supply of capital on suitable terms; the shortage is aggravated by the fact that, in many instances, the cost of capital has been fixed by regulation at rates that do not reflect the prevailing situation of the market. Shortage of finance for working capital requirements is accentuated by an artificial increase in demand created by the tendency of industrial enterprises to protect themselves against erosion of their assets and to profit from price increases by maintaining inventories which under normal circumstances would be considered excessive. The market for long-term loan capital has dried out completely for lack of supply. One consequence is that, at present, industrial investment loans can only be obtained from official financial institutions with access to budgetary or other Governmental funds.

16. The inflation has also had an impact on financial institutions. Normally, a financial institution does not invest more than a small fraction of its equity in fixed assets (office buildings and equipment) which are protected against the erosion of the currency. In an inflationary environment, the desire of the banks to escape deterioration of capital by investing in real estate may lead them to set up extensive networks of branch offices, as has actually been the case in Brazil. To a certain extent, adequate protection can be found by investing in the share capital of business enterprises. Those parts of the institution's equity which are used to finance their lending activities have to be protected against erosion either by an indexation of the principal or by interest and commission rates exceeding the inflation rate or by a sufficient leverage with non-indexed deposits or borrowed funds. Also, the operating costs of financial institutions are largely accounted for by personnel expenses which normally follow closely the inflation rate. Unless the institution's total assets and liabilities keep pace with the inflation rate, which does not happen automatically, except in cases where they are indexed, the evolution of expenses will result in a squeeze on the profit margin and possibly a deterioration of the equity.

III. BANCO DO NORDESTE DO BRASIL S.A.

Objects and Functions

17. BNB's objective is to contribute to the economic development of the Northeast by providing financial assistance to productive enterprises in agriculture and industry, financing certain infrastructure projects undertaken by states and municipalities, and in general by conducting all commercial and investment banking activities, including underwriting and leasing operations, within its area of operations as defined by Law No. 3,995 of 1961 (see above paragraph 2).

Ownership (see Annex 1)

18. The legislation creating BNB stipulated that at least 70% of BNB's initial share capital would be subscribed by the Federal Government, while the remaining 30% would be open to public subscription, and that the Government would have the same preferential rights as all the other stockholders in case of future capital increases, but that all the shares offered to the public and not subscribed would also be taken up by the Government. Initially, the Government owned 70%, state governments and municipalities 4.9% and the private sector 25.1% of BNB's share capital. Due to insufficient subscriptions by the private sector during a capital increase in 1965, the participation of the Federal Government increased to 87.8%. It was reduced again to 72.9% at the occasion of a capital increase from NCr$ 15.2 million to NCr$ 140 million which was completed in June 1969. Following this increase, some 40,000 private shareholders, two thirds of them residing in the Northeast of the country, own around 25.6% of BNB's capital.

19. Originally, the Minister of Finance was responsible for exercising the Government's rights as BNB's principal shareholder. Since 1967, the exercise of these rights has been entrusted to the Minister of Interior, who also supervises SUDENE.

Legal Status

20. The legal basis of BNB's establishment in 1954 was Law No. 1,649 of July 19, 1952 supplemented by Presidential Decree No. 33,643 of August 24, 1953. The company is constituted as a limited company (Sociedade por acoes) and as such is governed by Brazilian company law and its statutes; however, all modifications of its statutes have to be approved by Presidential Decree. BNB is furthermore subject to the Brazilian banking legislation to the extent that it is not in contradiction with the legislation creating it. Like the other financial institutions operating in the country, BNB is subject to the control of the Banco Central do Brasil.

Organization (see Chart, Annex 2)

21. The President. BNB's President is appointed for an indefinite term by the President of the Republic. He is the company's chief executive. BNB's President from 1956 until 1961 and again from 1962 to 1967, was Mr. Raul Barbosa who is now Executive Director for Brazil of the Inter-American Development Bank in Washington, D.C. He was succeeded by Mr. Rubens Vaz da Costa. Mr. Vaz da Costa, who is an economist by education, had been a staff member and, later on, the Head of BNB's Economic Department from 1954 to 1959. He then joined the Pan American Union in Washington and, from 1961 to 1966, was a staff member and later a Deputy Director of the Inter-American Development Bank. After a short time as Superintendent of SUDENE during 1966/67, he was appointed to his present position. He has been President of the Association of Latin American Development Banks; he is also a member of several professional associations and author of a number of economic publications, mainly dealing with problems of development in Brazil and the Brazilian Northeast. He provides BNB with competent and energetic leadership.

22. The Board of Directors. BNB's Board consists of the President and four Directors. (See Annex 3.) While the President is appointed by the President of the Republic, the Directors are elected by the General Assembly of Shareholders for a term of four years. Since the Federal Government holds a large majority in the General Assembly, BNB's Directors are in fact the candidates of the Ministry of Interior.1/ However, according to BNB's Articles of Association, the remaining shareholders may elect a candidate in a ballot in which the Government does not participate, each time their total participation in BNB's share capital is 20% or more. Since the 1968/69 share capital increase resulted in a reduction of the Government participation to less than 80%, the non-Government shareholders will be entitled to elect a Director for the first time in 1973 when the present term of BNB's Board expires.

23. All of BNB's Directors are full-time officers. Functionally, each one is responsible for one of BNB's major departments, presenting reports and applications of those departments during Board meetings. However, the Directors have no individual executive functions (with one small exception in the short-term lending program where certain lending decisions can be taken individually by the Director). During its meetings which take place at least once a week, BNB's Board decides on all policy matters and on major credit applications. The Board makes its decisions by a majority of votes, with the President having a casting vote in case of a tie. It appears that decisions are taken in a businesslike manner, and that the Ministry of Interior, while directing BNB's general orientation, does not interfere in day-to-day management and individual lending decisions.

1/ Apparently in connection with the transfer of the responsibility for BNB from the Ministry of Finance to the Ministry of Interior, all of BNB's Directors were replaced in 1967/68, although their terms of office were to expire in 1969.

24. Conselho Fiscal - Audit of Accounts. In accordance with Brazilian company law, the General Assembly elects a Control Council (Conselho Fiscal) of five members and five alternates to make a monthly audit of BNB's accounts. Such audit is, however, largely a formality and the tasks carried out by the Conselho Fiscal cannot be considered as a professional, independent audit. The Bank has therefore requested BNB to have its accounts audited by an independent firm of auditors acceptable to the Bank and BNB has procured the services of the well-known company, Arthur Young, Clarkson, Gordon & Co., which is now preparing an audit of BNB's books. The receipt of a certified copy of the report of the auditors, disclosing a satisfactory financial condition of the institution, is proposed as a condition of the effectiveness of the proposed loan.

25. Departments. BNB's Head Office has the following ten departments, all of them under the direct supervision of the President (in parentheses are numbers of staff at the end of 1968):

A. Service Departments

1. Department for Internal Audit and Inspections (36)
2. "Assessoria Geral", in charge of BNB's internal organization and planning (68)
3. Legal Department (13)
4. Department for Economic Studies on the Northeast (ETENE) (69)

B. Supervisory Departments

1. Industrial Credit Department (CARIN) (67)
2. Agricultural Credit Department (DERUR) (143)
3. General Credit Department (DERGE) (118)
4. Administrative Services Department (240)
5. Financial Department (DEFIN) (86)
6. Department for Staff Training (no staff of its own; functions carried out by other departments).

26. The functions of those departments are by and large explained by their names. In should, however, be noted that ETENE, the only department explicitly mentioned in BNB's statutes and in the basic legislation creating the institution, not only assists BNB's operational departments by its research work but also fulfills a public service through studying general problems of the economic situtation of the Northeast and making the results available to the public.

27. Branch Offices. Under its basic legislation and statutes, BNB has to maintain one branch office for each 400,000 inhabitants living in the dry areas, but at least two branches in each of the states in which it operates. In fulfillment of this condition, BNB has opened 67 branches during its 15 years of existence, and is continuing this policy. However, the operation of branches, especially in the remote and less densely

populated areas of the interior, creates problems of transport and communication and involves heavy operating expenses. Therefore, after a relatively quick expansion of its network in 1968 and 1969, during which period eleven new branch offices were opened, BNB is considering a slowdown of its expansion program. The feasibility of closing down some of its deficitary branches has also been considered but not pursued for the time being.

28. All operations are carried out by the branch offices, which although responsible directly to the President, are supervised on a day-to-day basis by the Head Office departments. Each branch has divisions for agricultural credit, general credit and services (treasury, accounts, personnel, files, etc.). Larger branches also have a division for industrial credit. On average, each of BNB's branches has 33 professional and five non-professional staff members, and even the smallest branches maintain a personnel of 16 to 20.

29. Staff. At the end of 1968, BNB had 3,564 staff members, of which approximately 2,980 were professionals. This was an increase of 58.6% over 1964 figures, as compared with a growth of total assets of 255.4% (at constant prices) and an increase in number of credit operations of 48.4%. However, while operations grew more quickly in 1965 and 1966, the important increases in staff occurred only in 1967 and 1968. Since the end of 1968, the number of staff has been kept constant, and BNB thinks that no increases will be necessary during the coming four or five years.

30. While bank employees in Brazil normally work 30 hours a week, BNB introduced a 40-hour week in 1967 and since then had been paying all its employees 10 hours overtime a week. However, early in 1969 it was felt that the workload did no longer justify keeping the entire staff on a 40-hour week and the 30-hour week was reintroduced as from September 1969. The diminishing return on BNB's equity during 1967 and 1968 (see below paragraph 73) was a factor in this decision.

31. Reportedly, BNB is looked at as a reservoir of well-trained financial experts and institutions like SUDENE, the development banks of the Northeastern States and industrial consultant companies of the region are recruiting former BNB staff members. Nevertheless, staff turnover has been very low and even decreasing during the past few years. While during 1964, 104 staff members (5% of total) left the institution, the number of resignations during 1968 was only 99, or 3.3% of total staff.

32. The Department Heads of BNB's Head Office at Fortaleza appear to be of outstanding quality. Each of them has a long record of satisfactory performance within the institution, and some of them combine their work at BNB with a professorship at the University of Fortaleza. It should be mentioned that the changes in BNB's Board during 1967/68 did not result in changes of the senior staff.

33. BNB's management gives much emphasis to training of staff at all levels. During 1968, 95 staff members attended professional courses in various institutions, and 363, i.e. more than 10% of total staff,

participated in BNB's internal training programs. In addition, BNB offered training facilities to 39 university students, and has taken in a considerable number of foreign trainees.

Resources

34. After distribution of the 1968 profits, BNB had the following resources (in million of NCr$, utilized portions only, percentagewise breakdown for 1967 and 1966 for comparison):

	1966 %	1967 %	1968 Amount	1968 %
Equity	9.0	12.5	199.2	16.1
Allocations from Federal Budget	4.3	3.8	24.7	2.0
Foreign loans (IDB)	5.3	5.3	64.5	5.2
34/18 deposits	65.0	65.0	672.1	54.5
Ordinary deposits	10.8	9.9	134.3	10.9
Rediscount lines	-	-	0.1	0.0
Sundry creditors	5.6	3.5	140.2	11.3
	100.0	100.0	1,235.1	100.0

The various lines of resources are discussed in the following paragraphs.

35. Equity. As at the end of 1968, BNB's equity of NCr$ 199.2 million was made up of its share capital (NCr$ 15.2 million), reserves (NCr$ 147.5 million) and paid-in subscriptions for new shares (NCr$ 36.5 million) under a rights issue which was finalized in June 1969. The share capital consisted of 15.2 million (and now consists of 140 million) nominative, common shares of a nominal value of NCr$ 1.00 each. All shares are equal except that no dividend may be paid on the Federal Government's holdings unless BNB's other shareholders are paid a dividend of at least 10% of the nominal value of their shares. No dividend may be declared in excess of 20% of share capital. The Federal Government may not withdraw the dividends paid by BNB on its shareholdings; those dividends must be kept in a special account with the institution and may only be used in payment of the Government's subscriptions of new shares on the occasion of increases of BNB's share capital.

36. Annex 4 shows the evolution of the company's equity accounts. According to its statutes, BNB has to set aside from its net profits (a) 5% for the legal reserve, (b) 10% for a reserve for drought risks and (c) 10% for a general credit reserve. These allocations as well as payments of staff bonuses, Directors' profit participations and dividends are made by BNB's Board; the remainder of net profits are annually allocated by the General Assembly of Shareholders. During the past years, share capital was only a small part of BNB's total equity and consequently the dividend payments (12% annually until 1965 and the maximum rate of 20% for 1966 and 1967) represented a very minor part of BNB's total profits, the majority

of which was allocated to several reserve accounts and contributed, together with cash subscriptions, to the rapid growth of BNB's equity. In fact, between 1964 and 1968 total equity increased from NCr$ 6.5 million (equivalent of NCr$ 22.6 million at 1968 prices) to NCr$ 199.2 million. Of this increase of NCr$ 192.7 million, only NCr$ 36.5 million were cash contributions, while NCr$ 156.2 million were generated from BNB's own profits.

37. Allocations from Federal Budget. BNB was originally conceived as a channel for part of the Federal Government's tax revenues that were earmarked for assistance to the dry areas of the Northeast. These funds, which, by law, amounted to 0.8% of the total annual tax revenue of the Federal Government, were deposited in a special account with BNB. While 30% of these annual deposits could be reclaimed by the Government at short notice in case of an emergency within the region, and consequently could only be employed at short-term, the remaining 70% was not repayable and could be used by the Government only for subscription of new shares on the occasion of increases of BNB's share capital. These funds, which did not bear interest, were thus a sort of quasi-equity although they were not in any way subordinated in the event of liquidation.

38. The earmarking of Federal Tax revenues for the Northeast was eliminated by the new Brazilian Constitution adopted in 1967. For BNB, this meant the loss of its most stable source of finance. When the new Constitution went into force, the Federal Government was in arrears to BNB by approximately NCr$ 90 million from previous tax revenue. During the second half of 1969, the Government made a first payment of approximately NCr$ 2 million on account of this arrear, and BNB expects to receive at least NCr$ 30 million during 1970. The amount shown in BNB's balance sheet for 1968 was a residue of payments made prior to the new Constitution, plus the Government's share in BNB's dividends, which may not be withdrawn; it was entirely used for subscriptions of new BNB shares during the first half of 1969.

39. Foreign Loans. As at the end of 1968, BNB had received from the Inter-American Development Bank six loans totalling US$ 53.29 million.[1/] Of these six loans, three totalling US$ 22 million were for private industry and three totalling US$ 31.29 million for water supply, sewerage and housing projects.

40. While commitment of the first loan for private industry took six years, all the following loans were committed relatively quickly, and in November 1969, only about US$ 2 million remained uncommitted under Loan 128/SF/BR made in June 1967. Under the terms of IDB's two latest loans for private industry, sub-loans above US$ 500,000 required IDB's previous approval. No sub-loans of more than US$ 1 million could be made except for projects of special merit. The cost of these two loans (interest and service charge, but excluding commitment charge) to BNB is 4% on IDB's Special Funds and 6.916% on IDB's Ordinary Capital Funds. Interest charged to the sub-borrowers is 7% and 9%, respectively, so that BNB earns a spread of 3%

1/ For details see Annex 5.

and 2.084%, respectively, on these two loans. Use of both loans is restricted to foreign exchange expenditures. The exchange risk is borne by the final borrowers.

41. <u>34/18 Deposits</u>. Presently, BNB's most important resources are the deposits made by Brazilian tax-payers under the 34/18 incentive scheme (see above paragraph 7). Annex 6 shows the status of these deposits from the beginning of the scheme in 1962 until the end of 1968 and BNB's forecasts over the coming five years. Recent movements of the 34/18 deposits seem to indicate that the position at the end of 1969 may be some NCr$ 75 to NCr$ 100 million higher than projected by BNB, and that also BNB's forecasts for the near future may be on the conservative side. Nevertheless, there is a considerable degree of uncertainty in the evolution of this important resource (which at the end of 1968 financed 54.5% of BNB's total assets) for the following reasons:

a. The volume of inflowing deposits depends on the attractiveness of the Northeast as against alternative uses of the 50% tax credit. These alternatives are mainly the Amazon region which was made eligible for investment of tax credits in 1963 and which is already attracting 23% of all tax credits, as against the Northeast's 65%, and such priority sectors as fishery, tourism and reforestation.

b. The pace of disbursement of the deposits is partially set by SUDENE; to the extent SUDENE speeds up its approval procedure, the average period of the deposits with BNB (which at present is between 12 and 18 months) and consequently their total volume decreases.

c. An investor may submit his project to SUDENE and receive SUDENE's approval even prior to the due date of his tax liability and thus the period of the deposit with BNB may be reduced to a few days.

42. While BNB tries to attract funds to the Northeast by advertising campaigns and in direct approaches to large taxpayers in the Center-South of the country, the factors mentioned under b. and c. are practically out of BNB's control. Consequently, 34/18 deposits have to be considered as a relatively uncertain resource in the future. However, since they do not bear interest and are not subject to monetary correction, BNB can earn substantial interest margins on them.

43. It should be noted that the table in paragraph 34 shows only those 34/18 deposits which SUDENE has not yet authorized for investment. As soon as BNB receives such authorization, the deposits are transferred to demand deposit accounts, which are then included with ordinary deposits.

44. Ordinary Deposits. BNB may accept deposits from public and private sources. During the past few years, those deposits have accounted for approximately 8-12% of BNB's total assets. Virtually all of them have been demand deposits.

45. Deposits are relatively difficult to obtain since in the absence of monetary correction or adequate remuneration, depositors would not normally keep more money in bank accounts than strictly necessary for minimum working capital requirements. (Central bank regulations forbid payment of interest on demand deposits; BNB pays interest of 3-8% p.a. on term deposits of one month and more.) Nevertheless, the total volume of ordinary deposits has developed very satisfactorily over the past five years, with annual rates of increase of 10-50% in real terms. BNB's expectations of a further growth of deposits seem justified considering the increase of economic activity of the region, particularly if inflation continues to level off so that the losses (in real terms) to depositors are reduced.

46. Rediscount Lines. At present, BNB has the following rediscount facilities totalling NCr$ 142.0 million with the central bank:

a. NCr$ 80 million for rediscount of short-term loans to State Governments, at 15% p.a.

b. NCr$ 32 million for rediscount of short-term paper, at 12% p.a.

c. NCr$ 20 million for rediscount of a special operation (loan to a State electricity company), at 22% p.a.

d. NCr$ 10 million for rediscount of agricultural loans from 2 to 10 years, at 11% p.a.

So far, BNB has used only the agricultural rediscount, and only to a minor amount.

Operations

47. Factual information on BNB's operations is contained in Annex 7 which describes in detail the institution's operational policies, the interest rates charged and the evolution of BNB's short-term credits and agricultural and industrial loans. The figures presented in that annex show substantial though uneven growth rates in operations over the past years. Between the end of 1965 and the end of 1968, BNB's total outstanding loans increased by 147% from NCr$ 351.2 million (at 1968 prices) to NCr$ 869 million. Within this overall figure, the biggest increase was in agricultural lending (340%), while industrial lending increased by 185% and short-term credit by 68%. At the same time, however, it appears that BNB was not able to satisfy the growing demand for financing, especially in the field of industrial lending. This situation is clearly reflected in the increasing number and volume of projects in the pipeline as shown in the table "Flow

of Applications" (Appendix 7 of Annex 7), which also shows that BNB has approved virtually no new industrial loans since the end of 1968. In fact, early in 1969, BNB's Board decided not to increase its portfolio of long-term loans to industry and agriculture because of the limited availability of suitable resources. It appears that BNB will resume long-term lending after the end of 1969.

48. Evaluation of Policies and Procedures. BNB's policies appear to be well conceived. The branch managers have a considerable degree of freedom in their lending decisions in the agricultural lending program where loan amounts average only around NCr$ 6,000 and a greater concentration of authority could be impracticable. Short-term lending, where higher limits per client are involved (though the individual discount operations are small), is more closely controlled by the Head Office. In the industrial lending program, which involves the highest individual amounts, decision-making is entirely concentrated at Board level. Operations manuals and other instructions to the operational staff present clear and detailed guidelines.

49. As far as industrial lending in particular is concerned, the staff in charge of the program at BNB's Head Office demonstrates a satisfactory degree of competence, comparable to several of the better development finance companies now assisted by the World Bank. Project appraisals are thorough and of good quality. Market studies sometimes suffer from the scanty statistical information available for the Northeast region; in some cases deficiencies in this respect discovered by the appraisal staff lead to studies undertaken by BNB's economic department (ETENE), and the industrial credit department normally has a voice in determining ETENE's annual study program.

50. Follow-up on industrial loans is of outstanding quality. Visits to customers are thorough, and reports give a good analysis of the borrowers' situation and performance. A continuous supervision of the situation of BNB's industrial borrowers is greatly facilitated by BNB's commercial banking activities.

51. Administrative Costs. Administrative expenses incurred by BNB during 1968 in connection with its industrial lending department, including overheads, were approximately 2.4% of the program's proportional part of BNB's total assets. If the underlying assets were evaluated at 1968 prices, the ratio would be only 1.8%. Even the latter figure is on the high side if compared with old-established development finance companies in other countries, but this appears to be, at least in part, a result of the prevailing high salary level in Brazil. The cost of the program is, however, much lower than the cost of BNB's short-term and agricultural lending programs (see paragraph 75 below).

52. Quality of short-term portfolio. Since BNB is able to offer short-term credit at a lower cost than the commercial banks, it can afford to be selective in the choice of its customers. As a result of its conservative approach, its short-term portfolio appears to be of very satisfactory quality. Overdue bills were less than 3% of total outstanding short-term operations at the end of 1968. However, most of them were later paid, and BNB's actual losses were far below 1% of the outstanding portfolio during each of the past few years.

53. Quality of agricultural portfolio. It can be expected that, in such a vast lending program serving some 60,000 farmers in an area of more than 1.5 million square kilometers, collection of maturities is not easy. In such a situation the excellent repayment record of BNB's farmer-borrowers (loans to cooperatives, not included, have so far not produced any losses) as shown in the following table (in NCr$ 1,000) is noteworthy:

	Outstanding at end of year		Arrears 1/		% of Amount	Written Off		% of Amount
Year	No.	Amount	No.	Amount	Outstanding	No.	Amount	Outstanding
1967	37,476	114,466	3,676	6,151	5.4%	804	1,399	1.2%
1968	42,203	246,379	5,390	17,061	6.9%	1,709	3,519	1.4%

It should be mentioned that many of the loans written off are later paid back. BNB's total losses on agricultural loans, since beginning operations in 1954, were NCr$ 4.4 million or 0.9% of all loans made.

54. Postponements of maturities are granted by branch managers, within the limit of their authority for granting new loans, for periods not exceeding one year. No information is available on the frequency of postponements.

55. It is difficult to determine the effect of droughts on BNB's agricultural portfolio. About 40% of the agricultural loans are made in the "sertao" area, which is hardest hit by the periodical droughts. Annual maturities of investment loans to borrowers in this area would amount to some NCr$ 13.6 million. BNB would re-schedule those loans by one year and try to resume collections during the following year, but it may be safe to assume that about one-third of the maturities falling due in a drought year, i.e., some NCr$ 4.5 million, may have to be written off. In addition, BNB might lose NCr$ 5 - 6 million of current interest income on those loans. Concerning working capital loans, of which less than half are carried beyond the harvest season, difficulties in repayment are not likely to arise in more than 15-20% of the total outstanding amount; in most cases, rescheduling by one year would solve the problems, and BNB's loss would mainly be in unpaid interest.

1/ Outstanding amounts of loans in arrears on principal and/or interest of 3 months and more.

56. BNB's experience during the relatively severe drought of 1958 was much more favorable than the previous paragraph would suggest. Reportedly, losses on portfolio during that year were not higher than in normal years. This might be due to the fact that BNB's agricultural lending program is directed towards financing cattle-raising and cash crops, while the droughts mainly hit the subsistence crops, such as beans and millet.

57. Quality of Industrial Portfolio. Any judgment on BNB's industrial portfolio will have to take into consideration the effects of the inflationary environment on Brazilian industries. Especially during the years 1961 to 1964, when annual inflation rates reached 50-90%, BNB's industrial loans were practically gifts to the borrowers, and could normally be reimbursed from cash generation without difficulty. If, nevertheless, delays in repayment occurred, these were likely to be due to a borrower's speculation on further depreciation of the principal amount rather than to his difficult situation. Moreover, Brazilian industries had and still have a tendency to keep their working capital at a minimum level in order to minimize inflation losses, with the result that liquidity problems are frequent. Although BNB pays attention in its appraisal and follow-up work to a sufficient level of working capital, such working capital is normally kept in stocks of raw materials rather than in cash balances. This particular situation is at the basis of most of the rather frequent arrears in the repayment of BNB's industrial loans. BNB has, however, a very efficient way of recovering overdues through its short-term credit activities. Since virtually all industrial clients whose investment loans have reached the repayment stage are also using BNB's discount facilities, it is easy for BNB to retain part of the proceeds of discount operations for cover of overdues on industrial loans.

58. At the end of 1968, the repayment record of BNB's private industrial borrowers was as follows (in millions of indicated currency units):

	No.	Amount	Amount in percentage
Outstanding loans (amounts are gross before write-offs)	?1/	NCr$ 139.6	100%
	?1/	US$ 8.3	100%
Loans in repayment stage	95	NCr$ 67.7	48.5%
	27	US$ 6.2	74.7%
Outstanding amounts of loans in arrears on principal and/or interest of 3 months and more	32	NCr$ 14.4	10.3%
	8	US$ 1.8	21.7%
Written off as bad debts	10	NCr$ 0.3	0.2%
	1	US$ 0.06	0.7%

1/ Not available. As at January 31, 1969, there were 158 loans in cruzeiros and 33 loans in US dollars outstanding.

The installments actually overdue for three months or more at the end of 1968 on these loans were NCr$ 1.26 million plus US$ 0.41 million in principal and NCr$ 1.06 million plus US$ 0.6 million in interest.

59. Nearly half of the cruzeiro loans in arrears were represented by one big loan to a textile mill in Recife (outstanding amount NCr$ 6,071,400, overdue installment NCr$ 251,400). This company is operating normally, its financial structure is quite solid, and previous installments have been paid on the due date. The reason for the default is not clear but it is not likely to be serious.

60. The arrears position of the dollar loans is comparable to that of the cruzeiro loans in number of operations, but more serious in amount. Two important loans aggregating US$ 0.9 million, i.e. about half of the foreign currency loans in arrears, were made to two companies which are facing serious problems (a caustic soda plant, which encountered technical difficulties, and a sisal manufacturer who has lost part of his market following a change in import regulations); however, both loans are fully secured by guarantees and BNB expects to recover the outstanding amounts.

61. Postponements of maturities have been granted in very few cases and for periods not exceeding 12 months.

62. At present, no losses appear likely to arise on BNB's industrial portfolio apart from the above-mentioned 11 bad loans totalling NCr$ 300,000 plus US$ 60,000, which were fully written off.

63. Loans to public borrowers for basic services, which are secured by a pledge on tax revenues allotted by the Federal Government to the borrower, are virtually riskless. Also, the credit risk on BNB's loans to State Development Banks for relending to small enterprises seems negligible.

Financial Situation

64. Financial Structure. Annex 9 shows BNB's balance sheets for 1964 through June 1969. A significant feature in BNB's structure is the decline of the debt/equity ratio from a peak of 17.8:1 at the end of 1965 (which was comparable to internationally observed practices in purely commercial banking) to 10.1:1 in 1966, 7:1 in 1967, 5.2:1 in 1968 and 4.4:1 at the end of June 1969, as a result of high profit accumulations and of the 1968/69 capital increase against cash subscription. (For the purpose of determining this ratio, all liabilities including deposits have been considered as debt.)

65. It is normal practice to limit the maximum indebtedness of development finance companies to which the Bank makes loans, to a prudent multiple of the borrowers' unimpaired equity. Such a limitation restricts the borrowers' ability to incur risks connected with lending to (and investing in securities of) business enterprises. BNB asked for a limit of ten times its unimpaired equity. It was felt, however, that, in BNB's case,

a more refined approach to the problem of debt limitation was required. In fact, the risk connected with BNB's short-term operations is substantially less than the risk of its medium- and long-term loans, especially since BNB's short-term lending is mainly done by way of discount of trade bills which are self-liquidating and where more than one party is liable for the payment of the debt. In these circumstances, and considering the competence of BNB's management, the expertise of its appraisal staff and the quality of its present portfolio, an overall debt limit of 10:1 (inclusive of all short-term debt, deposits and accounts payable) seemed prudent if, within that overall limit, BNB's power to incur term debt (i.e. debt with initial maturities of more than one year) was restricted to four times its unimpaired equity. During negotiations, BNB accepted this two-tier debt limitation.

66. The twofold limitation has to be considered in connection with BNB's liquidity formula which determines the application of BNB's various resources in its long-, medium- and short-term lending operations and the minimum level of its liquid assets (see paragraphs 67 and 68 below). Taking account of requirements for liquid funds, the effect of the debt limitations will be to allow BNB's total loans and discount portfolio to go up to approximately nine times its unimpaired equity. Within this portfolio, term loans (in the Brazilian definition, for more than six months) may reach the approximate equivalent of seven times the equity. Both of the debt limitations leave BNB a very large margin for additional borrowings.

67. Liquidity. The nature of BNB's resources makes it imperative to pay particular attention to the liquidity of the institution, especially in view of the importance of the 34/18 scheme (see paragraph 41 above). Movements of 34/18 and ordinary deposits are watched continuously by BNB's organization and planning department, and the experience gained by this supervision is used in the elaboration of BNB's annual programs of operations, which contain formulas to determine BNB's maximum exposure in lending operations and its minimum liquidity holdings. These formulas are carefully devised and BNB's liquidity holdings have so far been sufficient to meet all its needs.

68. Annex 8 shows the formula adopted by BNB's Board for its fiscal year 1970. This formula is adequate in present circumstances. BNB intends to revise it at least annually and especially to reduce the percentage of the 34/18 deposits to be used in lending operations if and when a decline in the volume of these deposits appears likely. BNB has agreed that it would at all times apply to its operations a liquidity formula satisfactory to the Bank.

69. Profitability. Annexes 10 and 11 show BNB's profit and loss statements and the allocation of its net income for 1964 through June 1969. For a review of BNB's past profitability, it is necessary to recall that the institution operated at negative interest rates on its borrowings and deposits as well as on its loans, the only exception being its foreign currency business. This means that BNB's equity, insofar as it was employed in lending operations, was always producing a loss in real terms, and an erosion of the equity was only avoided by considerable leverage with free or low-cost funds.

70. The gross annual income from BNB's portfolio of loans and discounts has been relatively stable at between 15.9% and 17.1% of the average portfolio over the past few years. Gross income on average total assets (including monetary correction which was applicable mainly to BNB's holdings of Treasury Bonds) during the same period rose from 10.6% during 1965 to 14.2% during 1968, but fell back to 12.4% during the first half of 1969. The higher fluctuation in the latter ratio is due to variations in the volume of liquid funds and in their yield. In fact, during recent years BNB obtained a higher return on the investments it made with temporarily liquid funds, for which it purchased interest-bearing Treasury Bonds with full monetary correction, than on its loans and discounts, where rates were negative or at best equal to the inflation rate.

71. Total expenses (of which between 81% and 91% were administrative expenses, and the rest interest, commissions and depreciation of fixed assets) were 5.6% of average total assets during 1965, went down to 3.9% following a quick growth of assets during 1966, but increased again to 4.9% in 1967 and to 7.3% in 1968. The growth of expenses during the past two years was mainly caused by extremely fast increases in salaries and social benefits. While the number of staff grew by 12% in 1967 and 17% in 1968, the increase (in real terms) in personnel costs was 56% and 62% respectively. The main reason for these extraordinarily high increases was the shift to a 40-hour week during 1967 (see above paragraph 30), the transformation of the staff bonuses formerly paid out of net profits into a regular expense, an increase in social security contributions, and apparently also a quite liberal salary policy made possible after BNB's good profits in 1966 and 1967. Provisional results for the first half of 1969 show a relative decrease of total expenses to 6.2% of average total assets. If staff bonuses (which are now again being paid out of net profits) are added to expenses, the ratio is 7.2% p.a. which is still a fraction below the 1968 expenses.

72. BNB's operating profit (including monetary correction on Treasury Bonds) developed as follows during recent years (as a percentage of average total assets):

	1965	1966	1967	1968	First Half 1969 (annual rate)
(a) before adjustments for portfolio losses	5.0	8.6	7.9	6.8	6.2
(b) after adjustments for portfolio losses	5.0	8.6	7.6	6.0	5.4

As may be seen from this table, portfolio losses had an effect on profitability only since 1967. The relatively heavy write-offs in 1968 and 1969 were due to the adoption of a very cautious write-off policy and thus are likely to contain some hidden reserves.

73. The following table shows BNB's net earnings in absolute amounts and in relation to assets and equity:

	1965	1966	1967	1968	First Half 1969
Net profits (nominal) in NCr$ '000	9,052	37,198	37,213	42,407	35,510
Add: Monetary correction directly credited to reserves	764	16	15,916	20,075	17
Net earnings (nominal) in NCr$ '000	9,816	37,214	53,129	62,482	35,527
Net earnings at 1968 prices in NCr$ '000	21,703	59,431	65,986	62,482	32,926
a. Net earnings (nominal) as percentage of average total assets (nominal)	5.0	8.6	7.6	6.0	5.4(p.a.)
b. Net earnings (nominal) as percentage of paid-in share capital at end of period (nominal)	258.7	979.8	349.5	411.1	55.8(p.a.)
c. Net earnings (nominal) as percentage of average equity (nominal)	88.2	110.5	68.2	41.2	32.0(p.a.)
d. Net earnings (nominal) as percentage of equity at beginning of period (nominal)	150.6	236.4	102.9	60.0	35.7(p.a.)
e. Net earnings (real) as percentage of equity at beginning of period (i.e. after deduction of annual inflation rate)	93.5	197.9	74.3	35.8	19.8(p.a.)

Earnings have declined more sharply if measured against equity (c.) than if measured against total assets (a.). This is due to the fact that, during the period under consideration, BNB's equity has grown faster than its assets. BNB has practically no possibility of paying out its profits, since dividend distributions are limited by its statutes to 20% and the dividends accruing to the Federal Government are kept on deposit and eventually re-invested in BNB's equity.

74. BNB's shares are quoted on the Rio de Janeiro and Salvador Stock Exchanges. Quotations in Rio were in the range of 190-250% of par during October 1969, with a total turnover of some 280,000 shares during that month. On the basis of these prices and the 1968 dividend rate of 12%, the yield of BNB's shares was 4.8-6.3%. The net asset value of BNB's shares at the end of June 1969 was 184% of par.

75. Allocation of Income, Expenses and Profits. The contribution of the three lending programs (short-term, agricultural and industrial lending) to BNB's overall profitability varies, not only because of the difference in lending rates but also because of the workload involved. BNB's internal cost accounting makes it possible to determine BNB's income, expenses and net profits for 1968 in relation to each of the three programs. The following table shows the breakdown:

	Share in Total Outstanding Volume of Loans	Share in Total Income	Share in Total Expense	Share in Total Net Profits (nominal)	Share in Total Net Profits (adjusted)
Short-term	39.48%	52.3%	47.6%	61.7%	113.0%
Agriculture	31.19%	24.2%	38.8%	- 5.4%	-90.0%
Industry	29.33%	19.3%	13.6%	30.9%	34.5%
Short-term investments	-	4.2%	-	12.8%	42.5%
	100.00%	100.0%	100.0%	100.0%	100.0%

Expenses shown above include interest paid on borrowings and on certain types of deposits. If it is assumed that BNB's equity was used proportionately with other resources in its three lending programs and if net profits are reduced to real terms (i.e. if that part of net profits which was offset by the depreciation of BNB's equity due to inflation is added to expenses[1/]) the last column presents the picture of real contributions made by BNB's various operations to its profitability.

76. In absolute figures, BNB's net profit for 1968 in real terms would be NCr$ 12.8 million instead of the NCr$ 42.4 million shown in the balance sheet, and the agricultural lending program alone would result in a loss of NCr$ 11.5 million. All other factors remaining equal, the agricultural portfolio would have to earn five percentage points more interest than it did in 1968 to break even in real terms. The recent increase in interest rates on agricultural loans, when fully effective (i.e. after full repayment of the loans made at the old rate) is likely to result in an overall increase in earnings of only around two percentage points and would therefore cover only about 40% of the deficit. As shown in paragraph 75, the high personnel and other expenses involved in the agricultural lending program are primarily responsible for its deficit, whereas the industrial lending program, which involves lower expenses, made a sizeable contribution

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1/ This disregards the fact that during 1968, BNB was able to cover a large part of this depreciation by placing liquid funds in readjustable Treasury Bonds.

to BNB's net profit in spite of the fact that the prevailing interest on industrial loans during 1968 was lower than the interest on agricultural loans.1/ Measured against total capital employed, the internal return on BNB's industrial lending program (after administrative and other expenses, but before interest charges) was around 8.2% during 1968.

77. While there is a subsidy element in each of BNB's lending programs, the subsidy appears particularly high in agricultural lending, where the prevailing interest rates are presently not sufficient to cover fully BNB's costs. It should be added that BNB also renders some non-financial services to the Northeast region for which it does not receive any compensation. As mentioned above in paragraph 26, the department of economic studies performs research work on a larger scale than required to support BNB's operations; and it may be assumed that 50% of the department's expenses are in fact a contribution to the economic development of the region. Total direct cost of ETENE during 1968 was NCr$ 1.6 million, and indirect cost may be estimated at approximately NCr$ 500,000, resulting in a total expense of NCr$ 2.1 million or roughly 2.5% of BNB's total expenses, so that the cost of BNB's uncompensated economic research work is about NCr$ 1.05 million. While this figure is substantial in absolute terms, it is small if compared with BNB's total expenditures. BNB's contribution to the improvement of professional education within the region is not negligible but it has always been a by-product of the institution's internal training programs and cannot easily be expressed in figures.

Economic Impact of BNB's Industrial Lending Program

78. The attached Supplementary Report discusses in detail the economics of the Northeast Industrialization Program. Since the enterprises financed by BNB are part of this program, the conclusions of the Supplementary Report apply by and large to BNB's industrial lending program as well. A comparison of the sectoral and regional distribution of the two programs reveals that these are largely identical; BNB has, however, contributed more than proportionally to the financing of textile projects which account for nearly 28% of its total loan approvals, as against 17% in volume of SUDENE-approved projects, and has a relatively small share in the chemical sector (15% as against 27%) where some big projects seem to account for a large part of the total investment figure. BNB's loans are concentrated in the three states of Pernambuco, Bahia and Ceara to approximately the same extent (69% in number of total loans approved) as the SUDENE-approved projects (71%); if BNB's operations in these three states, measured in volume, are higher (86% of total approvals) than the corresponding percentage of the SUDENE-projects (81%), this seems to point to the fact that under the SUDENE point system, projects in these three states obtain less 34/18 funds and have, therefore, higher loan financing requirements.

79. During the years 1965-68, BNB disbursed, or started disbursements on, loans to 101 private industrial enterprises totalling US$ 45 million equivalent. Total investment in the projects financed by these loans is

1/ This interest pattern was reversed at the beginning of 1969 when the rate for industrial investment loans in local currency was increased from 14% p.a. to 22% p.a.

estimated at US$ 93.2 million equivalent. These figures correspond to approximately 14% and 30%, respectively, of total industrial investment in the area during the period. Estimated new employment created by these projects is 12,644 jobs. This would result in an average investment cost per job created of approximately US$ 7,400, which comes very close to the figure of US$ 7,500 quoted in the Supplementary Report. Annual gross value added by these projects after completion is estimated at US$ 49.3 million or US$ 3,900 per job created. For comparison, gross value added by manufacturing industry in the Northeast during 1966 was US$ 414.7 million, the total labor force was 184,000, and gross value added per worker was US$ 2,250. Unfortunately, BNB has never determined to what extent its industrial lending activities will contribute to an increase in export earnings. BNB should, as part of its follow-up activities and of its economic studies, review the actual performance of the industrial enterprises it has financed, from the viewpoint of economic impact.

The Outlook

80. Need for Additional Resources.(a) Present Resources. BNB's resources shown in its balance sheet as at June 30, 1969, would, in accordance with the liquidity formula described in Annex 8, permit BNB to increase its outstanding long-term loans1/ by an amount of NCr$ 24.9 million (in local currency). In addition, BNB may utilize its long-term agricultural rediscount facility with the central bank for NCr$ 10 million, which would bring its total available long-term local currency resources to approximately NCr$ 35 million. Furthermore, BNB has uncommitted foreign exchange resources of US$ 2 million under one of the two IDB loans for private industry which BNB received in 1967. Proceeds of this loan are restricted to procurement from member countries of IDB.

81. (b) Prospective Demand for Finance. Appendix 7 of Annex 7 shows the inflow of applications for BNB's industrial loans. There was quite a steady flow until and including the first quarter of 1969; after the end of March 1969, new applications decreased sharply when it became known that BNB had temporarily discountinued its long-term lending (see paragraph 47 above). However, it may be assumed that the flow will resume at a pace at least equal (in constant prices) to that of 1968 and early 1969, as soon as BNB starts lending to industry again (which it intends to do early in 1970), the more so since disbursements of 34/18 deposits, which are an indicator of the investment activity in the region, are increasing as projected. Thus, the assumption seems justified that BNB will receive requests for new loans to private industry during 1970 and each of the next following years of at least NCr$ 235-265 million (at 1968 prices) of which NCr$ 140-150 million would be for local currency expenditures and NCr$ 95-115 million (equivalent of US$ 25-30 million) for financing of imported goods and services. These estimates of applications could be expected to result in net commitments as follows:

1/ Only long-term loans are made under BNB's industrial lending program.

	NCr$ million (at 1968 prices)	US$ million
Annual applications	140-150	25-30
Deduct: Rejected or returned (33% 1/)	47- 50	8-10
Gross approvals	93-100	17-20
Deduct: Withdrawn after approval (20% of approvals 1/)	19- 20	3- 4
Net annual commitments	74- 80	14-16

In addition, the backlog of unprocessed projects as of September 30, 1969 might result in net commitments as follows:

	NCr$ million (at 1968 prices)	US$ million
Unprocessed as at September 30, 1969	120	25.5
Deduct: Rejected or returned (33% 1/)	40	8.5
Gross approvals	80	17.0
Deduct: Withdrawn after approval (20% of approvals 1/)	16	3.4
Net commitments	64	13.6

Given these figures, it would seem conservative to assume that BNB's potential commitments of investment loans to private industry during each of the next two or three years would be not less than NCr$ 100 million plus US$ 20 million. These calculations have been made on the assumption that BNB would have the necessary resources both in local and foreign currency; they disregard the impact of the proposed increase of BNB's lending rates.

82. BNB intends to increase its lending rate on industrial loans to 10% (with full indexing of the principal) for local currency loans of more than five years (from presently 22% net without indexing) and to 10% (from presently 9%) on foreign exchange loans, with the exchange risk carried by the final borrower. The impact of this increase in lending rates on BNB's future industrial lending is difficult to evaluate. When the rate for local currency loans was increased from 14% to 22% at the end of 1968, all applicants were notified and very few of them decided to withdraw their applications, but even 22% was a negative rate if compared with the rate of inflation of 24.2% during 1968. However, equity for industrial projects in the Northeast is rather easily available under the 34/18 scheme, and in the past only around one third of the projects approved by SUDENE has come to BNB for loan financing, so it cannot be ruled out that, if the cost of loan financing substantially exceeds past levels, many of BNB's potential clients

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1/ Percentages of applications rejected/returned and withdrawals after approval are those observed during 1968.

will prefer to finance their whole projects from equity. It seems impossible to give more than an order of magnitude of the impact of an increased cost of money on the volume of BNB's lending; however, the change from near or below zero (in real terms) to a true cost of 10% p.a. could cause a decrease of future applications of up to 50%. This would mean that net commitments of local currency loans to private industry might, in the worst case, be only NCr$ 50 million annually (at 1968 prices) instead of NCr$ 100 million as estimated above.

83. As far as foreign exchange loans are concerned, it is not expected that an increase of BNB's lending rate from the current 9% (on loans made with the Inter-American Development Bank's ordinary capital funds) to 10% would have any significant impact on BNB's volume of foreign exchange loans which, moreover, has been estimated conservatively.

84. Since, in the past, BNB's foreign currency loans have generally been made simultaneously with local currency loans, the foreign exchange component of projects sometimes being relatively small, it must be expected that some requests for foreign currency loans will be withdrawn if BNB is not able to accommodate its customers with local currency loans because of a shortage of cruzeiro resources. A check of the unprocessed applications for loans to private industry as at March 31, 1969, showed that around two thirds of the requests for foreign exchange were in conjunction with requests for cruzeiro funds. Theoretically, this would mean that if half of the local currency loans BNB would otherwise have approved were refused because of a shortage of local currency resources, and if all the applicants that were thus turned down were to withdraw their requests for foreign currency assistance, the volume of foreign currency lending would decrease by one third; in other words, the estimates of annual net commitments of NCr$ 100 million plus US$ 20 million would have to be reduced to NCr$ 50 million plus US$ 13 million. However, it appears too pessimistic to assume that refusal of local currency funds would automatically lead to a cancellation of a simultaneous application for a foreign currency financing, so that in such circumstances an estimate of US$ 15 million annually would probably be more realistic.

85. (c) Resources Requirements. To support these estimates and projections, additional resources in foreign and local currency are necessary. For foreign currency to finance the import component of projects, BNB has asked for a loan of US$ 25 million which should cover foreign exchange requirements for lending to private industry for a period of around 18 months.

86. Annex 14 shows the projected limits of BNB's exposure in long-, medium- and short-term lending operations. Those limits result from the application of BNB's liquidity formula (described in Annex 8) to its resource forecasts as shown in the balance sheet projections (Annex 12). Based on these projections, the following table gives an estimate of BNB's local currency resources available for disbursements of long-term loans during 1970 and 1971 (in NCr$ million, at current prices):

	1970	1971
Increase in maximum availability for long-term loans	210	309
Deduct: Estimated increase in outstanding foreign currency loans	40	80
Margin for increase of local currency loans	170	229
Add: Estimated repayments on local currency loans	83	100
Estimated total available for disbursements of local currency loans	253	329

In principle, there should be no difficulty for BNB to allocate, out of these totals, to its industrial lending program a sufficient portion to cover the expected net commitments of local currency loans to private industry which are, as stated above (see paragraph 81) in the order of NCr$ 100 million annually at 1968 prices (i.e. approximately NCr$ 138 million for 1970 and NCr$ 152 million for 1971 at current prices). This would leave BNB with enough free funds to continue its agricultural investment lending. Nevertheless, to make sure that BNB will actually be able to provide long-term local currency funds to the industrial sector in sufficient amounts even in the face of a shortfall of the resources BNB projects to have available or an extraordinary increase in demand for agricultural investment finance, BNB has undertaken to make arrangements that would enable it to draw on supplementary resources in the case its ordinary resources were insufficient to carry out, within the limits set by its liquidity formula, a program of long-term industrial lending involving net commitments of at least NCr$ 100 million a year during 1970 and 1971. This undertaking is backed by the commitment of the Government as guarantor to enable the borrower to perform its obligations under the Loan Agreement.

87. Financial Structure and Profitability. Annexes 12 and 13 are operational forecasts for the period 1969 through 1973. These forecasts are, of course, fraught with considerable uncertainty due to the inflationary environment. While the projections concerning the 34/18 deposits, which will remain one of BNB's principal resources, have been made very carefully and conservatively, their evolution is subject to several uncertainty factors (see paragraph 41 above). Also, the future growth of ordinary deposits will very much depend on the pace of inflation in the years to come.

88. BNB's profit and loss projections, while reasonable in themselves, obviously are derived from and conditional upon the evolution of its volume of business and especially of its resources. Provided these develop as expected, BNB is likely to make annual net profits (in nominal terms) of the order of 29-31% of its equity, which would be sufficient to protect the institution against the erosion of its equity even if inflation were to continue at rates of 20% p.a., and to leave a moderate surplus as a

safeguard against possible portfolio losses exceeding the normal level of bad debts. However, BNB continues to operate in an uncertain environment; moreover, BNB continues to lend at negative interest rates and below its own cost in its agricultural lending program and consequently depends on leverage with non-indexed, low-cost funds and on other lending programs to operate profitably. In order to protect the interests of the Bank as creditor, the Bank asked BNB for, and BNB agreed to give, an undertaking that it will take all action necessary to ensure that its annual return (in real terms) will not drop below 5% of its equity. This undertaking is backed by the commitment of the Government as guarantor to enable the borrower to perform its obligations vis-a-vis the Bank. The rate of 5% is deemed sufficient to keep BNB's equity intact at its present level (in real terms), even if it has to absorb more than normal portfolio losses.

89. While this undertaking was requested in order to assure an adequate equity underpinning of the proposed Bank loan, we were concerned also about a satisfactory return of the capital employed by BNB as an indicator of the effective use of such capital. However, since BNB combines a variety of functions, including some which are purely public services (like its research and training program) and some which contain important elements of subsidy (like the agricultural program), it was not meaningful to apply the test of an adequate return on capital to the institution as a whole. It therefore seemed appropriate to isolate for this purpose BNB's industrial lending program, especially since use of the proposed Bank loan will be restricted to financing of industry. BNB undertook that the return (in real terms) on capital employed by it for industrial lending and investing would not be less than the Bank's lending rate applicable to the proposed loan, i.e. not less than 7%. This appears to be satisfactory. Since BNB intends to charge 10% interest on both its local and foreign currency loans for investment in industry, and since its administrative expenses during 1968 were 1.8% of the (revalued) capital employed in the program (see above paragraph 51), BNB should have no difficulties in meeting this test which, according to the agreement reached during negotiations, will be applied to all industrial loans (and investments, if any) made by BNB after the end of 1969. To allow for a transition period, it was nevertheless agreed to apply the test for the first time to BNB's fiscal year ending on December 31, 1971.

IV. CONCLUSIONS AND RECOMMENDATIONS

90. Further development of the industrial sector of the Brazilian Northeast is desirable to strengthen the economy of the region. On the whole, the Government's policies to this purpose are well conceived and carried out although a full-scale review of the incentive scheme should be undertaken, with a view to possible revisions. Meanwhile, the distorting effect of negative interest rates is being reduced by the introduction, as of January 1970, of a new pattern of interest rates for long-term industrial investment finance to be applied by the banking institutions of the official

sector. BNB has affirmed its policy to seek to assure the highest possible proportion of non-34/18 equity funds in the financing of the projects to which it makes loans and that it will not submit for Bank financing, except in special circumstances, projects in which non-34/18 funds account for less than 25% of total estimated investment cost, compared to the 12.5% permitted by SUDENE in certain cases.

91. BNB is a well-managed and well-organized development bank with a long and generally satisfactory record of experience. It is the most important source of finance for investment in industry of the region, and has contributed to the economic development of the Northeast not only financially but also by economic research activities and the technical assistance rendered to numerous borrowers through its important branch network.

92. BNB's business expectations are good, in terms of both operations and profitability. It can meet these expectations, however, only if it can acquire additional long-term resources in local currency and in foreign exchange.

93. In view of its good performance, its satisfactory operational standards and its contribution to the economic development of the Northeast, BNB may be considered a suitable recipient for Bank loans. A loan of US$ 25 million is recommended to cover BNB's requirements of foreign currency for financing the import component of the cost of private industrial projects over a period of around 18 months. This loan should contain provisions normal in Bank lending to development finance companies, including provisions for commitment charge. Furthermore, the following conditions have been agreed to by BNB during negotiations:

a. BNB will at all times apply to its operations a formula, satisfactory to the Bank, defining its maximum exposure in long-term, medium-term and short-term lending in accordance with its different resources, to assure that the institution maintains a satisfactory degree of liquidity.

b. BNB's total indebtedness will be limited to ten times the amount of its unimpaired equity; however, total outstanding term debt (with initial maturities of more than one year) will not exceed four times its unimpaired equity.

c. BNB will undertake to take all action that may be necessary to ensure (a) that its annual return (in real terms) will not drop below 5% of its equity and (b) that the return on capital invested in BNB's industrial lending program will not drop below a rate equal to the Bank's lending rate on the proposed loan, which will be 7%.

d. BNB will make arrangements to enable it to draw on supplementary resources in the case its ordinary resources are insufficient to carry out, within the limits set by its liquidity formula, a program of long-term industrial lending involving net commitments of at least NCr$ 100 million a year during 1970 and 1971.

e. The proceeds of a Bank loan will be relent at a rate at least 2.5% above the rate charged by the Bank, which would leave BNB a modest margin after covering its administrative expenses in connection with its industrial lending activities. The exchange risk would be assumed by the final borrower.

f. The Bank's prior approval will be required for all projects using more than US$ 250,000 from the loan; judging from BNB's past foreign exchange loans (from IDB resources), approximately 40% in number and 84% in value of the sub-loans would be above this limit. The aggregate amount of sub-loans not requiring the Bank's prior approval will be US$ 5 million.

g. BNB will have its accounts audited annually by a qualified independent auditor acceptable to the Bank; receipt of a report on the first audit made, disclosing a satisfactory financial position of the institution, will be a condition of effectiveness of the proposed loan.

BANCO DO NORDESTE DO BRASIL S.A.

Evolution and Distribution of Share Capital

(in NCr$ 1,000, at current prices)

A. Evolution

1954:	Initial share capital		100
1965:	Capital increase by way of:		
	a) Revaluation of assets (bonus shares)	500	
	b) Transfers from reserves (bonus shares)	300	
	c) Subscriptions under rights issue		
	(i) Federal Government (against special deposits with BNB)	2,780	
	(ii) Others (cash)	192	
			3,700
	Share capital from February 1965		3,800
1967:	Capital increase by way of transfers from reserves (bonus shares)		11,400
	Share capital from September 1967		15,200
1968/69:	Capital increase by way of:		
	a) Transfers from reserves (bonus shares)	45,600	
	b) Subscriptions under right issue	79,200	
	Share capital from June 1969		124,800
			140,000

B. Ownership (in % of share capital)

	1954	1965	1969
Federal Government	70.0	87.8	72.9
State Governments	3.3	0.8	0.9
Municipalities	1.6	0.4	0.6
Total public sector	74.9	89.0	74.4
Companies	7.0	3.1	n.a.
Individuals	18.1	7.9	n.a.
Total private sector	25.1	11.0	25.6
	100.0	100.0	100.0

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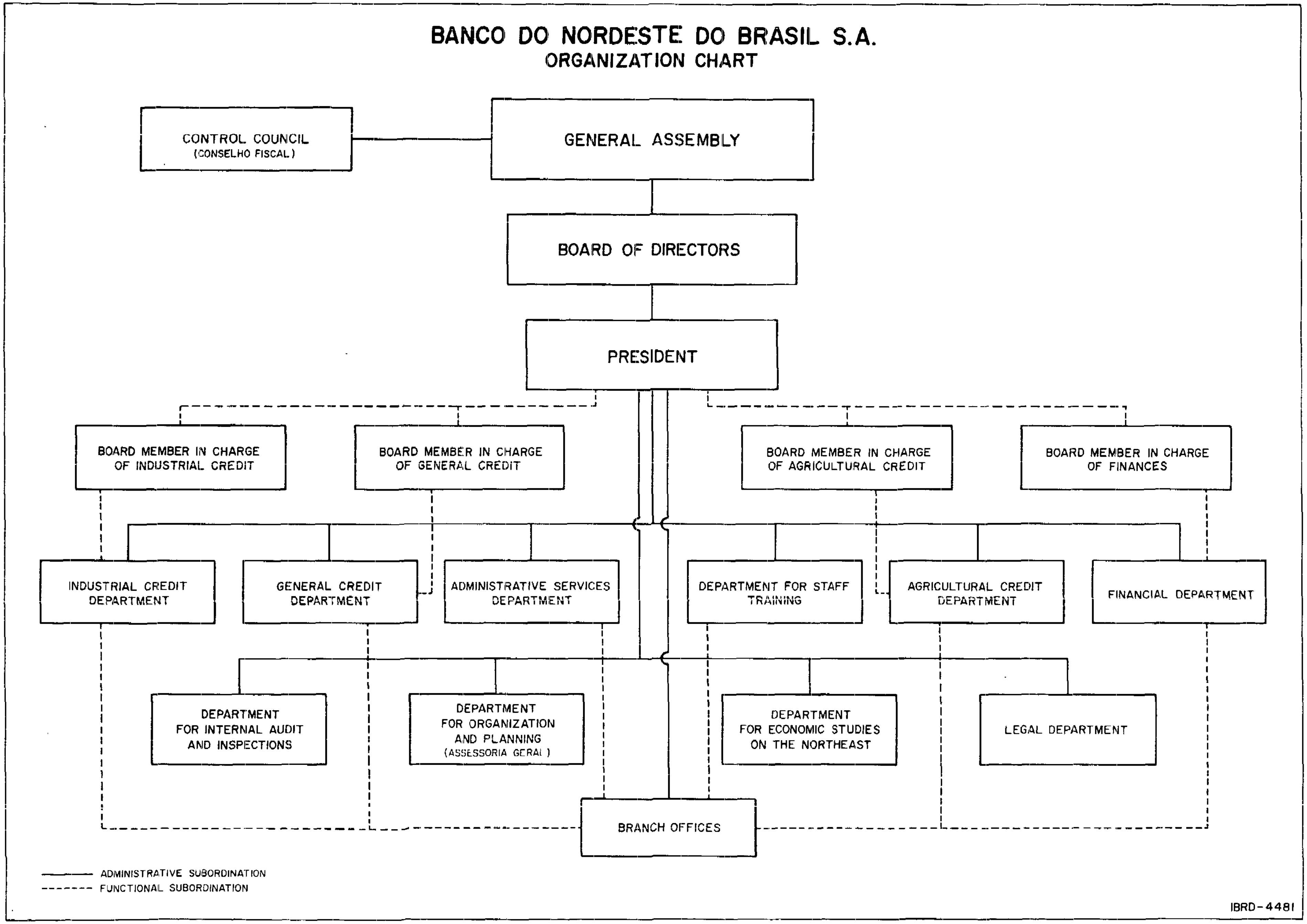
December 9, 1969


BANCO DO NORDESTE DO BRASIL S.A.
ORGANIZATION CHART
CONTROL COUNCIL (CONSELHO FISCAL)
GENERAL ASSEMBLY
BOARD OF DIRECTORS
PRESIDENT
BOARD MEMBER IN CHARGE OF INDUSTRIAL CREDIT
BOARD MEMBER IN CHARGE OF GENERAL CREDIT
BOARD MEMBER IN CHARGE OF AGRICULTURAL CREDIT
BOARD MEMBER IN CHARGE OF FINANCES
INDUSTRIAL CREDIT DEPARTMENT
GENERAL CREDIT DEPARTMENT
ADMINISTRATIVE SERVICES DEPARTMENT
DEPARTMENT FOR STAFF TRAINING
AGRICULTURAL CREDIT DEPARTMENT
FINANCIAL DEPARTMENT
DEPARTMENT FOR INTERNAL AUDIT AND INSPECTIONS
DEPARTMENT FOR ORGANIZATION AND PLANNING (ASSESSORIA GERAL)
DEPARTMENT FOR ECONOMIC STUDIES ON THE NORTHEAST
LEGAL DEPARTMENT
BRANCH OFFICES
ADMINISTRATIVE SUBORDINATION
FUNCTIONAL SUBORDINATION
IBRD-4481

ANNEX 2

BANCO DO NORDESTE DO BRASIL S.A.

Board of Directors

Name	Position	Term of Office
Rubens Vaz da Costa	President	-
Luis Carlos Bello Parga	Director of General Credit	1973
José Cortez Pereira de Araújo	Director of Agricultural Credit	1973
Hilberto Mascarenhas Alves da Silva	Financial Director	1973
Murillo Borges Moreira	Director of Industrial Credit	1973

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August 11, 1969

BANCO DO NORDESTE DO BRASIL S.A.

Movement of Capital Accounts

(in NCr$ 1,000 at current prices)

	1964*	Changes in 1965	1965*	Changes in 1966	1966*	Changes in 1967	1967*	Changes in 1968	1968*	Changes in First Half of 1969	June 30, 1969
Share Capital	100	(+2,900 3/4/) (+ 500 5/) (+ 300 3/)	3,800	-	3,800	+11,400 3/	15,200	-	15,200	(+115,443 3/) (+ 9,357 4/)	140,000 8/
Capital Increase Account	2,166 8/	-2,166 3/	-	-	-	+44,800 4/	44,800 8/	+25,043 4/	69,843 8/	- 69,843 3/	-
Reserves											
Legal Reserve	253	+ 429 1/	682	+ 1,825 1/	2,507	+ 1,819 1/	4,326	+ 2,120 1/	6,447	+ 1,357 1/	7,804
Reserve for unspecified credit risks	331	+ 859 1/	1,190	+ 3,650 1/	4,839	+ 3,638 1/	8,477	+ 4,241 1/	12,718	+ 2,715 1/	15,433
Reserve for specified credit risks 6/	7	+ 39	46	+ 58	104	+ 2,264	2,368	- 2,368	-	-	-
Reserve for possible losses	-	-	-	-	-	-	-	-	-	+ 8,361 1/	8,361
Reserve for drought risks	1,443	+1,324 1/	2,767	+ 4,348 1/	7,115	+ 4,474 1/	11,589	(+ 673 1/) (+ 4,241)	16,503	(+ 2,715 1/) (+ 222)	19,440
Reserve for rural risks	506	+ 859 2/	1,365	+ 3,650 2/	5,015	-	5,015	-	5,015	-	5,015
Reserve for capital increase (constituted by revaluation of assets)	48	+ 264 5/	312	+ 16 5/	328	+15,916 5/	16,244	+20,058 5/	36,302	- 29,800 3/	6,502
Reserve fund for capital increase (Constituted from income)	300	(+2,200 2/) (- 300 3/)	2,200	+10,000 2/	12,200	(+15,000 2/) (-11,400 3/)	15,800	+25,800 2/	41,600	- 15,800 3/	25,800
Reserve for assistance to employees	173	+ 270 2/	443	+ 474 2/	917	+ 220 2/	1,137	+ 578 2/	1,715	-	1,715
" for social charges	200	+ 200 2/	400	+ 270 2/	670	-	670	-	670	-	670
" for direct investments	333	+ 200 2/	533	+ 1,000 2/	1,533	+ 5,000 2/	6,533	+ 3,000 2/	9,533	-	9,533
" for construction of office buildings	700	+1,300 2/	2,000	+10,000 2/	12,000	+ 4,000 2/	16,000	-	16,000	-	16,000
" for monetary corrections on real estate loans	-	-	-	-	-	-	-	+ 17 5/	17	+ 17 5/	34
" for monetary corrections on fixed assets	4	-	4	-	4	-	4	-	4	-	4
Workers indemnity fund 7/	-	-	-	+ 590	590	+ 223	813	+ 197	1,010	+ 27	1,037
Total	6,564	+9,178	15,742	+35,881	51,622	+97,354	148,976	+83,600	232,577	+ 24,771	257,348
Same at 1968 prices	22,803		34,806		82,440		185,028		232,577		238,506

NB: Figures may not add up due to rounding.
* End of year, and after allocations.
1/ Allocation from net profit made by Management.
2/ Allocation from net profit made by General Assembly.
3/ Transfers from and to other equity accounts.
4/ Cash contributions or transfers from accounts other than equity.
5/ Revaluation of assets.
6/ Since 1968, bad debts are written off directly, hence this reserve has been cancelled.
7/ Allocations made out of administrative expenses.
8/ Of which: unpaid subscriptions 48(1964); 44,800(1967); 33,341(1968); 12,600(1969).

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ANNEX 4

BANCO DO NORDESTE DO BRASIL S.A.

Terms and Conditions of Inter-American Development Bank Loans

No. of Loan	Date of Loan Agreement	Purpose	Amount (millions of US$)	Term (Years)	Interest Rate	Exchange risk carried by	Amount Committed as at 12/31/68	Amount Disbursed as at 12/31/68
3/SF/BR	April 3, 1961	Private Industry	10	16 (4)	4 1/2%	Final Borrower	9.70	9.70
30/TF/BR	May 2, 1963	Water supply and Sewerage	12.99	30	2 3/4+3/4%	Govt.	12.99	12.19
40/TF/BR	Dec. 13, 1963	Low cost Housing	3.85	26	1 1/4+3/4%	Govt.	3.85	2.06
123/SF/BR	June 30, 1967	Water Supply	14.45	25 (4)	2 1/4+3/4%	Final Borrower	14.45	1.45
128/SF/BR	June 30, 1967	Private Industry	6.0	16 (4)	3 1/4+3/4%	Final Borrower	3.19	1.13
141/OC/BR	June 30, 1967	Private Industry	6.0 2/	16 (4)	6 1/2 for US$ 6 1/2 + 1 1/4 for Sfrs	Final Borrower	7.30 3/	1.23
			53.29					

1/ Figures in parentheses are grace periods included in the total terms of the loans.

2/ US$ 4 million plus Sfrs. 8.75 million.

3/ Commitments of US$1.3 million were made in excess of the loan amount. BNB expects that some of its sub-loans will be cancelled in due course.

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December 9, 1969

ANNEX 5

BANCO DO NORDESTE DO BRASIL S.A.

Past and Projected Evolution of 34/18 Deposits

(in millions of NCr$, at current prices)

Year	Deposits received during year	Disbursements authorized by SUDENE	Other Debits 1/	Position at Year End
1962	5.7	-	0.0	5.7
1963	7.7	0.1	0.1	13.1
1964	37.3	4.2	0.9	45.2
1965	149.4	8.7	0.0	185.9
1966	226.6	42.7	0.6	369.2
1967	351.1	178.1	0.7	541.6
1968	456.7	322.3	3.9	672.1
1969 2/	601.0	528.0	3/	745.0
1970 2/	673.0	673.0	3/	745.0
1971 2/	848.0	883.0	3/	710.0
1972 2/	932.0	982.0	3/	660.0
1973 2/	1,068.0	1,128.0	3/	600.0

NB: Figures may not add up due to rounding.

1/ Deposits forfeited after expiry of term or repaid to taxpayers following adjustment of their tax liability.

2/ BNB's forecasts, based on projected income tax revenues. The share of 34/18 deposits in total tax revenues has been assumed to decrease from 27% in 1969 to 20% in 1973.

3/ Negligible amounts.

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December 9, 1969

BANCO DO NORDESTE DO BRASIL S.A.

Operations

I. Operational Policies and Procedures

1. Within broad guidelines contained in Chapter VII of the Articles of Association, BNB's Board decides on the institution's operational policies. The following note gives a brief description of present policies and procedures as contained in BNB's Articles of Association, Board Resolutions and Operational Manuals.

General Policies

2. BNB shall not lend more than 60% of the value of the security of its loans; in exceptional cases and for operations against pledge of agricultural products, this limit may be increased to 80%. Terms of loans shall not normally exceed 10 years except for loans from special long-term resources. Lending decisions shall be made on the basis of the economic merits of the projects, taking into consideration the profitability of the investment, its direct or indirect impact on the national production, its gestation period, and its benefits to the population as a whole. No regard shall be paid to proportional distribution of BNB's lending activities among the States of its area of operation, except if the projects presented for financing are strictly equal as to their economic merits. BNB shall cooperate, whenever necessary, with other financing institutions and preferably with Government-owned or cooperative credit institutions.

Short-term Lending and Discounts

3. Although BNB has been conceived as a development finance institution with a special vocation in agricultural and industrial investment finance, the character of its resources make it impossible for BNB to use them exclusively at medium- and long-term. Furthermore, BNB's commercial banking business is a service to its agricultural and industrial customers especially in the interior of the region where the network of commercial bank agencies is insufficient.

4. BNB's short-term credit is only available for productive purposes. Priority is given to financing of sales of merchandise by way of discount of commercial paper (accepted trade bills and invoices). Inventories of merchandise are normally financed only at the stage of the producer and to the extent the volume of the inventories does not exceed normally admitted limits. BNB also finances purchases of agricultural products

during the period of the harvest by traders specializing in such commerce; other short-term financing of agricultural products at the stage of the trader is avoided as far as possible since BNB prefers to assist the producers through its specialized agricultural lending program.

5. BNB also makes short-term advances to the Governments of the Northeastern States. These advances serve to close the gap between budget expenditures, which are distributed fairly evenly throughout the fiscal year, and revenues which are generated mainly during the second half of the year.

6. Detailed operational manuals edited and periodically revised by the Head Office regulate the operating procedures. The authority of the branch managers in determining individual lending and discount limits for customers is very limited; according to the size of the branch, the managers may authorize limits of NCr$ 4,000 to 20,000. Higher limits have to be authorized by the Head of the General Credit Department of the Head Office (up to NCr$ 20,000), the Board member in charge of General Credit (up to NCr$ 40,000), the President (up to NCr$ 100,000) or BNB's Board (above NCr$ 100,000).

Agricultural Lending

7. The purpose of BNB's agricultural loans is to enable the farmer to put his property to a more efficient use or to assist him in introducing new farming techniques. BNB requires the farmer to submit plans of the operation to be financed, and to share in its cost. Loans are made for financing of investments or working capital. The following types of agricultural investments are eligible for BNB financing: permanent crops (cotton, bananas, etc.); dams, wells, irrigation works; pastures; livestock improvement; improvement or expansion of milk production; acquisition and expansion of livestock; acquisition of agricultural machinery; seed production; formation of small agricultural industry; acquisition of beasts for farm work; forestation and reforestation; barn and silos; rural housing; fences; other farming improvements; and apiculture.

8. Working capital loans are made mainly for cattle raising and expenses in connection with cotton growing.

9. Loans are made either directly to farmers or through agricultural cooperatives. In accordance with a general rule contained in BNB's Articles of Association, loans to cooperatives are made at lower interest rates than direct loans to farmers for the same purpose (see para. 24).

10. BNB's branch managers are authorized to decide on loans within limits of NCr$ 12,000 to NCr$ 30,000 according to the size of the branch.

Because of the small average size of the loans, 98% (in number) of all agricultural loans fall within these limits; the remaining 2% exceeding the limit are submitted to BNB's Board.

11. The agricultural lending program requires a considerable amount of technical assistance from BNB, both in helping the farmers draw up the project and in follow-up. At the end of 1968, BNB's head office and branches employed not less than 95 "Fiscais-Orientadores", trained agronomists or veterinarians who are constantly in the field to supervise BNB's agricultural borrowers.

Industrial Lending

12. BNB's industrial lending program may be subdivided as follows:

a. lending to private mining and manufacturing enterprises;
b. lending for "basic services" (public utilities run by mixed companies and State and municipal agencies);
c. lending to State development banks for relending to small enterprises.

13. In principle, BNB can assist any type of private mining and manufacturing industry established in the Northeast of the country, provided the project has been approved by SUDENE. BNB's main policies for lending to private industrial enterprises are laid down in its Board Resolution No. 320 dated June 2, 1960 (see Appendix I). This resolution and other policy guidelines set relatively rigid conditions for individual loans, among them the following:

a. The amount of BNB's loan may not exceed 50% of the total investment cost (fixed assets plus initial working capital).

b. At least 50% of the total investment cost has to be covered by the sponsor's own funds.1/

c. All loans have to be secured by a first mortgage on the whole industrial property (this condition makes additional loans from other financial institutions normally impossible); in addition, BNB may at its discretion request a pledge on movable assets or personal guarantees.

d. The repayment period of the loan is determined by BNB on the basis of the expected debt service capacity of the project.

1/ "own funds" here means total equity, including shares subscribed with 34/18 funds.

e. BNB will only consider applications received from regularly incorporated private enterprises, accompanied by a full project study. Such project study should have been prepared either by the enterprise itself or by an industrial consultant ("escritório técnico") registered with BNB.

14. The idea that no loan should be given unless for a well determined project and on the basis of a well prepared study was a novelty for the Brazilian Northeast when first proclaimed by BNB during its early days 15 years ago. In spite of initial resistance from traditional enterprises of the region, BNB has always defended this idea with almost missionary zeal, making it known through courses and conferences, with the result that BNB's standard appraisal format is now widely used in the Northeast by SUDENE, the State Development Banks and the "escritórios técnicos". One special aspect of the format is that the financial justification of an industrial project is demonstrated by way of determining the return on total assets (in constant prices), after deduction of an opportunity cost of total capital employed of 12% p.a. 1/ The return on total assets determined by this method is one of the yardsticks used by BNB in its lending decisions. This means that

a. only projects whose return on capital employed exceeds the opportunity cost of 12% by an appreciable margin (6% and more, according to the type of industry) are financed by BNB,

b. little or no attention is paid to the return on equity which is inflated in practically all cases by negative interest rates on borrowings from BNB and other sources and by the inflationary environment in general.

15. BNB has no policy regulations or lower or upper limits of its assistance to industry. However, small enterprises are referred to the State Development Banks for financing under BNB's small industry program, and operations of more than NCr$ 10 million and/or US$ 2 million are offered to Banco Nacional do Desenvolvimento Economico (BNDE) under the "Protocol of Recife" defining the methods of cooperation between BNB and BNDE. This agreement, which was concluded on August 9, 1967, and signed by the Presidents of BNDE and BNB as well as by the Ministers of Interior and of Planning, defines the cooperation of the two main government-owned development banks of the country and the coordination of their operations in the Northeast. Besides the criterion of loan amounts mentioned above, the Protocol stipulates that BNDE shall assist

1/ This figure was chosen by BNB to serve as a yardstick in its profitability calculations and does not pretend to reflect the actual opportunity cost of money at any given time.

industrial projects which, although located in the Northeast, produce for the national market or are important consumers of raw materials coming from other parts of the country. Thus, BNB's activities are limited rather narrowly to assisting medium-size industrial projects of regional importance. BNB's President is however, of the opinion that the seemingly strict wording of the Protocol reflects BNB's limited resource position in 1967 and its desire to see BNDE channel more of its resources into the Northeast, and that BNDE would in no way object if BNB, after having received new resources, stepped up its activities even beyond the line drawn by the Protocol.

16. Besides financial assistance to private industry, BNB's industrial lending program includes financing of basic services and small industries. "Basic services" are public utilities and infrastructure projects undertaken by State and Municipal agencies and mixed companies. These loans are secured by a pledge, in favor of BNB, on the taxes allotted by the Federal Government to the State or Municipality sponsoring the project.

17. Lending to small industries is done through the development banks of the Governments of each of the 10 States of the Northeast. BNB's Board Resolution No. 1,528 of September 27, 1967, which fixes the conditions of the program, stipulates that the aggregate volume of funds employed in it may not exceed 10% of BNB's total loans to industry. Within this limit, not more than one-fifth may be lent to one single development bank. Any industrial enterprise (except bakeries and manufacturers of alcoholic beverages and tobacco) whose total fixed assets do not exceed NCr$1,560,000[1/] is eligible for assistance under the program. The entrepreneur has to contribute at least 10% of the cost of his investment project proposed for financing; the State Development Banks has to finance at least another 10% of the cost from its own resources; the remaining 80% may be financed from BNB's loans. However, no sub-loans made out of BNB's loans to the State Development Banks may exceed NCr$ 470,000.[1/] The credit risk of the sub-loans is borne entirely by the State Development Banks. BNB has worked out the necessary forms and procedures to be used by the State Development Banks, especially the very detailed forms for project appraisals; they follow closely the pattern used by BNB in its own direct industrial lending operations. Furthermore, BNB has trained, and continues to train, the staff of the State Development Banks in charge of the program, which involves a considerable volume of technical assistance in helping the applicants to prepare the projects and in follow-up. The State Development Banks are free to use BNB's loans within the terms and conditions of the loan agreements, and BNB does not have to approve individual sub-loans. However, BNB controls the institutions quite

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1/ This figure is linked to the wage-scale in Brazil and increases periodically.

closely by way of periodical follow-up visits, and their operational performance is taken into account by BNB when new loans are considered.

18. All lending decisions under the industrial lending program have to be taken by BNB's Board irrespective of the amount involved.

19. Follow-up visits are made by specialized groups from the Head Office staff, five of them located in Fortaleza and one in Recife. A group consisting of one engineer and an accountant normally spends one week on one visit (including travel time, which may be long if the project is located in a remote part of the area), plus two or three days on report writing. The groups follow a strict and very complete checklist. Recommendations are implemented through BNB's branches. BNB's target is to make a visit every three months to companies under construction and once a year to companies in operation. The capacity of the follow-up division is still insufficient to meet this target, in spite of a considerable increase in the follow-up staff towards the end of 1968. Nevertheless, the present capacity of 200 visits a year may be considered quite good if compared with the number of outstanding loans which at present is approximately 180.

20. In addition, BNB receives copies of the follow-up reports made by SUDENE's follow-up staff, but those are normally less detailed than BNB's own reports. Furthermore, BNB's Industrial Credit Department benefits from the information available in the General Credit Department, because virtually all industrial clients are using BNB's short-term credit and discount facilities. The branch offices cover those follow-up activities connected with the control of disbursements and guarantees.

Equity Investments

21. Under its Articles of Association BNB may invest in equity of industrial or other enterprises. However, it is no longer active in this field since there is no shortage of equity for industrial projects due to the 34/18 scheme and since BNB, as a Government-owned institution, does not want to acquire ownership in private enterprises. The six equity investments which BNB carries in its books and which represent less than 0.1% of the institution's total assets, were acquired between 1960 and 1962, before the 34/18 scheme came into effect.

II. Terms and Conditions of Lending Operations

22. Short-term lending and discounts

Since May 1969, BNB charges interest of 1.6% per month for loans and discounts of up to two months and of 1.8% per month for operations of two to six months (prior to May 1969, BNB charged interest plus commission of 22% p.a.). These are the rates generally charged by commercial banks in Brazil. However, while commercial banks usually retain compensating balances of up to 30% of the loan amount, BNB requires compensating balances of only 10%.

23. BNB's discount operations are made for periods of 45 to 180 days. Short-term credits in current accounts, which are always secured by commercial paper, pledge on inventories etc., are made for periods up to 180 days or at daily notice.

24. Agricultural lending

a. Direct loans (investment and working capital)[1/]:

(i) for loans above NCr$ 7,800[2/]:

12% p.a. interest plus 6% p.a. commission (7 plus 6, except for certain types of cattle financing made at 12 plus 6);

(ii) for smaller loans, 9% interest net (6 net); increase to 12% p.a. envisaged.

b. Loans through cooperatives:

(i) investment loans:

10% p.a. interest plus 2% p.a. commission; final cost to sub-borrowers 18% p.a.

(ii) working capital loans:

7% p.a. interest plus 2% p.a. commission; final cost to sub-borrowers 18% p.a.

1/ These rates are charged for operations made since March 1, 1969. Prior rates are shown in parenthesis.

2/ This figure is linked to the wage-scale in Brazil and increases periodically.

(iii) loans for sale of machinery:

9% p.a. interest plus 2% p.a. commission;

(iv) Loans for marketing of products:

12% p.a. net.

25. The periods of BNB's agricultural loans are the following:

a. Direct loans

(i) for investment: normally from 3 to 10 years according to the type of investment financed, including grace periods of up to two years;

(ii) for working capital: from 6 months to 2 years, normally repayable in one single installment.

b. Loans through cooperatives

(i) for investment: from 3 to 8 years according to type of investment financed, including grace periods of up to one year;

(ii) for working capital: from 6 to 18 months, repayable in accordance with repayments of the sub-loans or sales of small equipment distributed by the cooperatives.

26. A study of a sample of approximately 1,000 loans shows that 82% (in value) of the loans for working capital have maturities of one year or less. Of the investment loans, 10% have maturities of 1 to 3 years, 52% between 3 and 5 years, 35% between 5 and 8 years and 3% between 8 and 10 years.

27. Industrial Lending. Until the end of 1968, BNB charged interest of 12% plus a commission of 2% p.a. on its loans to private industry and for basic services. On operations approved since January 2, 1969, BNB charges 12% interest plus 10% p.a. "monetary correction". This monetary correction is in fact an additional interest rather than a true compensation for the erosion of the Brazilian currency.

28. The interest rate charged by BNB to the State Development Banks is 7% p.a. The maximum cost to the final borrower is 14%, leaving a spread of 7% p.a. to the State Development Banks. In BNB's opinion the subsidy element in the cost to the final borrower is justified mainly by the fact that the small industries of the Northeast have no access to the 34/18 scheme which is the main incentive for industries of the region.

29. Recent foreign exchange loans to private industry (from IDB credit lines) carry interest at 7 and 9% p.a., with the foreign exchange risk carried by the final borrower.

30. BNB's loans to private industry are normally for periods of 2 to 10 years including appropriate grace periods (6 months to 3 years) with a median repayment period of 5 to 7 years. So far, only two loans have been made for repayment periods exceeding 10 years.

31. Loans for basic services are normally made for a maximum term of 20 years. Some loans for 25 years have been made in exceptional cases. Loans to State Development Banks are made for 5 years including one year of grace.

32. From January 1, 1970, BNB intends to charge 12% p.a. interest plus 10% p.a. "monetary correction" on loans of up to 60 months. Loans of more than 60 months will be fully indexed, and interest of 10% p.a. will be charged on the indexed principal amounts. Loans from IBRD funds are to be made at 10%, with the foreign exchange risk carried by the final borrower.

III. Volume of Operations

33. Approvals of operations have developed as follows over the period 1965-68 (in NCr$ million, at 1968 prices):

	1965		1966		1967		1968	
	No.	Amt.	No.	Amt.	No.	Amt.	No.	Amt.
Bills discounted	255,686	494.9	293,758	546.6	314,338	590.9	370,127	772.1
Short-term loans	73	2.8	55	18.3	34	126.7	31	77.7
Total short-term 1/	255,759	497.7	293,813	564.9	314,372	717.6	370,158	849.8
Agr. Working Capital Loans	13,790	39.6	17,187	67.1	18,280	103.1	16,591	101.2
Agr. Investment Loans	6,589	23.0	7,074	33.8	10,689	73.1	10,733	96.6
Loans to Cooperatives	139	6.6	152	10.4	216	13.8	239	34.0
Total Agriculture	20,518	69.2	24,413	111.3	29,185	190.0	27,563	231.8
Private Industry 2/	49	72.8	43	103.6	42	92.8	79	153.3
Basic Services	66	23.8	44	25.6	81	86.0	67	34.7
State Dev. Banks	-	-	-	-	10	30.3	2	8.5
Total Industry	115	96.6	87	129.2	133	209.1	148	196.5

1/ Short-term lending statistics are on a disbursement basis.

2/ Subsequent increases of loans due to price increases are included in amounts, but not in numbers of operations. Simultaneous loans in NCr$ and US$ are counted as two operations.

34. The following table shows the composition of BNB's loan portfolio at the end of the years 1965-1968 (in NCr$ million, at 1968 prices):

	1965		1966		1967		1968	
	Amt.	%	Amt.	%	Amt.	%	Amt.	%
Short-term lending	196.2	55.9	203.7	43.0	272.7	41.1	330.5	38.0
Agr. Working Capital loans	31.8	9.0	58.5	12.4	93.9	14.1	106.2	12.2
Agr. Investment loans	30.6	8.7	49.3	10.4	97.3	14.7	168.2	19.4
Total Agriculture	62.4	17.7	107.8	22.8	191.2	28.8	274.4	31.6
Private industry	69.6	19.8	120.5	25.5	149.0	22.4	170.8	19.6
Basic services	23.0	6.6	41.0	8.7	49.8	7.5	76.9	8.9
State Dev. Banks	-	-	-	-	1.0	0.2	16.4	1.9
Total Industry	92.6	26.4	161.5	34.2	199.8	30.1	264.1	30.4
Total	351.2	100.	473.0	100.0	663.7	100.0	869.0	100.0

35. Appendixes 2 to 7 show the regional distribution of the outstanding portfolio, a breakdown of commitments of loans to private industry according to purpose, terms, sector of activity, size and regional distribution, as welll as the flow of applications for industrial lending.

IBRD/DFC
December 9, 1969

Fortaleza, June 2, 1960

OFFICE OF THE PRESIDENT

RESOLUTION No. 320

CARIN - Confirming rules, bases and conditions to be observed in carrying out the special program for the financing of regional development projects.

The Board of Directors of the BANCO DO NORDESTE DO BRASIL, S.A., at its 434th meeting, held on June 2, 1960, adopted the following

RESOLUTION:

I. To confirm the rules, bases and conditions, set forth in summary form below, now being observed by the Carteira Industrial e de Investimentos (CARIN) in carrying out its special program of loans for Capital-formation purposes, designed to stimulate the setting up, expansion, modernization and relocation of industries;

1. For the purposes of the program referred to in the foregoing paragraph, use shall be made of the funds provided for in the Bank's investment budget.

2. Loan proposals may be submitted by entrepreneurs direct to any of the Bank's operational branches, the participation of middlemen at any phase in this procedure being forbidden.

3. Whenever such proposals have been submitted through SUDENE, by virtue of the provisions of Article 27 of Law No. 3.692 of December 15, 1969, only documents forwarded through that institution shall be considered for study.

4. Consideration shall be given only to proposals emanating from legally-constituted private enterprises, and these proposals shall be accompanied by a PROJECT making it possible to examine the background history and position of the entrepreneur, as also the purpose, viability and economic merits of the proposed undertaking.

5. For the purposes of this Resolution, the term PROJECT shall be understood to mean the whole of the data and basic information relating to the proposed undertaking, and covering at least the following aspects of it:

(a) production program, showing specifications and quantities of goods that will be produced, as also the hours of work required, by day, month and year, to carry out that program;

(b) indication of the possibilities of selling the said goods (market study and sales program);

(c) method of producing the said goods, with evidence of the suitability of the equipment and installations, plus details of the production process to be employed;

(d) data concerning requirements of raw and secondary materials, power, water and labor (skilled or unskilled staff), so as to show the feasibility of the proposed program of production;

(e) calculation of the profit-earning capacity of the project in terms of the program of production laid down, comprising an estimate of anticipated income from the output of goods and services, and a breakdown of the total expenditure required to secure that income;

(f) a summary indication of all existing capital assets, their historical cost and estimated present value;

(g) total estimate of new investments proposed, plan for raising funds and probable timetable for the purchase of equipment and carrying out of the work, until the project is operational;

(h) estimates of financial resources of a permanent nature required to ensure the proper operation of the enterprise (average stocks of raw materials, secondary materials, finished or other products; average of claims receivable that is expected to keep in the portfolio; production cycle expenditure; minimum cash reserves)

(i) means by which fresh investments will be combined with existing ones so as to form an industrial complex;

(j) a brief demonstration of how the enterprise will be able to discharge the commitments that it is seeking to assume.

6. Projects submitted must be accompanied by prospectuses, Articles of Association, balance sheets, plans, catalogs, photographs, and any other documents that may be required to substantiate or demonstrate the data and information supplied.

7. When proposals are examined, each enterprise submitting a proposal shall be regarded as a single group of indivisible interests.

8. Loans shall be complementary in nature, so that when added to the enterprise's own resources, the total amount shall suffice to meet the whole of its permanent requirements.

9. The term "permanent requirements" shall be understood to mean the technical fixed assets (imobilizaçoes técnicas) (industrial complex) and the financial fixed assets (imobilizaçoes financeiras), as defined in Item 5 letter (h) of this Resolution.

10. The share of the enterprise's own resources, whether already invested or to be invested during execution of the PROJECT, may in no case be less than 50% of the total investment, due regard being paid to the following :

    (a) the "total investment" shall be regarded as representing the sum of the "technical fixed assets" and the "financial fixed assets";

    (b) an extra accounting revaluation of the "fixed assets" (technical fixed assets), on a conservative basis and fully documented shall be accepted for the purposes of such participation;

    (c) the following shall not be reckoned as part of the enterprise's participation: "Profits in suspense" (LUCROS SUSPENSOS), balances that are at the disposal of General Meetings, loans from partners and shareholders, or any other resources that have not been finally incorporated in the equity of the proposer;

    (d) any participations that the proposer may hold in other enterprises shall also be left out of account in (reckoning) his share in the total investment.

11. The maximum approvable loan may not exceed 50% of the total investment.

12. Whatever may be the rates of interest or charges for supervision stipulated, the Bank reserves the right to readjust from time to time, due regard being paid to the legal provisions in force.

13. Subject to a maximum period of 20 years, the periods allowed for repayment shall be laid down in terms of the actual repayment ability of the enterprise, calculated in accordance with its probable profit-earning capacity, as estimated by the maker of the proposal and accepted by the Bank.

14. No loans shall be made to enterprises, whose industrial complex or part thereof, is subject to real liens (vinculado a obrigacoes de direito real).

15. All applications for loans for the purpose of recovering capital invested in fixed assets of any nature, or for the consolidation or payment of debts shall be considered, from the outset as outside the scope of the program to which this Resolution relates.

16. This exclusion shall not extend to any payments made, or any expenditure incurred, after the submission of the proposal and relating to items provided for in the PROJECT, even though, for reasons of overriding necessity, they may have had to be made or incurred before the proposal was dealt with.

17. All loans made on the basis of the program referred to in this Resolution, have as their purpose the advancement of capital formation in the enterprises financed, and action shall be taken to ensure that the repayment of any portion of the principal is counterbalanced by an increase, at least as great as the amount of the sum repaid, in the equity of the enterprise, such increase taking the form, whenever possible, of an addition to the company's capital stock.

II. The Carteira Industrial e de Investimentos (CARIN) is hereby authorized to issue to its branch offices instructions designed to facilitate liaison with the institutions concerned in the carrying out of this program.

(signed)

RAUL BARBOSA
President

BANCO DO NORDESTE DO BRASIL S.A.

Regional Breakdown of Loans Outstanding

(including Bills discounted)

(in % of total portfolio at year-end)

State	Population[1/]	% of Total Northeast	1964	1965	1966	1967	1968
Alagoas	1,439,000	5.3	5.3	3.9	3.6	4.5	4.5
Bahia, of which	7,165,000	26.4	11.7	13.7	14.0	12.9	19.2
a) Salvador	950,000	3.5	9.0	10.7	10.9	9.0	14.6
b) Other Bahia	6,215,000	22.9	2.7	3.0	3.1	3.9	4.6
Ceara, of which	3,983,000	14.7	22.4	23.2	17.7	18.1	16.1
a) Fortaleza	893,000	3.3	9.8	10.6	10.4	10.5	10.1
b) Other Ceara	3,090,000	11.4	12.6	12.6	7.3	7.5	6.0
Maranhao	3,685,000	13.5	0.0	0.0	0.0	0.0	1.1
Minas Gerais	n.a.2/	n.a.2/	5.5	5.3	4.0	5.0	6.2
Paraiba	2,314,000	8.6	15.1	15.1	14.6	14.2	11.3
Pernambuco, of which	4,882,000	18.0	19.8	23.2	30.6	30.9	27.7
a) Recife	1,130,000	4.2	14.3	15.8	24.8	24.4	22.0
b) Other Pernambuco	3,752,000	13.8	5.5	7.4	5.8	6.5	5.7
Piaui	1,469,000	5.4	4.8	3.0	2.9	2.9	3.0
Rio Grande do Norte	1,337,000	4.9	10.0	8.1	8.3	6.8	6.0
Sergipe	874,000	3.2	5.4	4.5	4.3	4.7	4.9
Total	27,148,000	100.0	100.0	100.0	100.0	100.0	100.0

NB: Excluding Loans in Foreign Currencies and Loans to Employees.

1/ Source: Brazilian Statistical Yearbook 1966.

2/ Total population of Minas Gerais is 11,975,000 but only a small part of the state is within the drought area covered by BNB.

IBRD/DFC
August 11, 1969

BANCO DO NORDESTE DO BRASIL S.A.

Breakdown of Industrial Term Loans Committed According to Purpose/Term

A. In NCr$ 1,000 at current prices/US$ 1,000.

	1964		1965		1966		1967		1968		Total	
	No.	Amount	No.	Amount	No.	Amount	No.	Amount	No.	Amount	No.	Amount
Purpose												
New Enterprises	6	931	15	6,955	16	12,946	14	18,410	24	39,239	75	78,481
	1	$ 1,440	8	$ 1,507	10	$ 2,112	2	$ 176	8	$ 5,360	29	$ 10,595
Extension of Existing	16	2,961	15	6,619	44	34,305	34	29,098	26	18,290	135	91,273
Enterprises	6	$ 1,795	2	$ 236	6	$ 1,128	1	$ 4	3	$ 957	18	$ 4,120
Total - NCr$	22	3,892	30	13,574	60	47,251	48	47,508	50	57,529	210	169,754
Total - US$	7	$ 3,235	10	$ 1,743	16	$ 3,240	3	$ 180	11	$ 6,317	47	$ 14,715
Terms												
2 to less than 5 years	3	199	3	926	6	2,936	5	479	8	4,830	25	9,370
	-	-	1	$ 88	-	-	-	-	-	-	1	$ 88
5 to less than 8 years	14	1,874	21	7,328	39	27,511	36	37,011	32	30,383	142	104,107
	3	$ 1,633	5	$ 401	7	$ 502	3	$ 180	5	$ 2,625	23	$ 5,341
8 to less than 10 years	2	398	6	5,320	10	8,475	5	7,548	7	18,487	30	40,228
	1	$ 207	4	$ 1,254	7	$ 2,239	-	-	4	$ 2,530	16	$ 6,230
10 to less than 15 years	3	1,421	-	-	5	8,329	1	370	3	3,829	12	13,949
	3	$ 1,395	-	-	2	$ 499	-	-	2	$ 1,162	7	$ 3,056
15 years and more	-	-	-	-	-	-	1	2,100	-	-	1	2,100
	-	-	-	-	-	-	-	-	-	-	-	-
Total - NCr$	22	3,892	30	13,574	60	47,251	48	47,508	50	57,529	210	169,754
Total - US$	7	$ 3,235	10	$ 1,743	16	$ 3,240	3	$ 180	11	$ 6,317	47	$ 14,715

B. In NCr$ 1,000 at 1968 prices*/US$ converted at 3.830

	1964 No.	1964 Amount	1965 No.	1965 Amount	1966 No.	1966 Amount	1967 No.	1967 Amount	1968 No.	1968 Amount	Total No.	Total Amount	%
Purpose													
New Enterprises	7	8,749	23	21,149	26	28,764	16	23,539	32	59,768	104	141,969	48.6
Extension of Existing Enterprises	22	17,161	17	15,539	50	59,105	35	36,155	29	21,955	153	149,915	51.4
Total	29	25,910	40	36,688	76	87,869	51	59,694	61	81,723	257	291,884	100.0
Terms													
2 to less than 5 years	3	691	4	2,385	6	4,689	5	595	8	4,830	26	13,190	4.5
5 to less than 8 years	17	12,765	26	17,738	46	45,858	39	46,657	37	40,437	165	163,455	56.0
8 to less than 10 years	3	2,175	10	16,565	17	22,110	5	9,375	11	28,177	46	78,402	26.9
10 to less than 15 years	6	10,279	-	-	7	15,212	1	459	5	8,279	19	34,229	11.7
15 years and more	-	-	-	-	-	-	1	2,608	-	-	1	2,608	0.9
Total	29	25,910	40	36,688	76	87,869	51	59,694	61	81,723	257	291,884	100.0

* General Price Index determined by Getulio Vargas Foundation.

IBRD/DFC
December 9, 1969

ANNEX 7
Appendix 4a

BANCO DO NORDESTE DO BRASIL S.A.

Breakdown of Industrial Term Loans Committed by Sector of Activity

A. In NCr$ 1,000 at current prices/US$ 1,000

Sector	1964 No.	1964 Amount	1965 No.	1965 Amount	1966 No.	1966 Amount	1967 No.	1967 Amount	1968 No.	1968 Amount	Total No.	Total Amount
Non-metallic	4	217	4	1,314	10	4,870	5	6,120	2	1,189	25	13,710
minerals	-	-	1	$ 324	3	$ 856	-	-	-	-	4	$ 1,180
Metallurgical	7	1,155	5	2,642	16	10,270	12	13,439	6	5,561	46	33,067
	1	$ 133	2	$ 205	4	$ 1,123	1	$ 4	2	$ 718	10	$ 2,183
Food Products	1	50	6	815	9	5,891	9	3,290	6	1,672	31	11,718
	-	-	2	$ 321	4	$ 528	1	$ 38	-	-	7	$ 887
Chemical	3	530	3	4,486	4	2,267	9	8,208	5	6,564	24	22,055
	1	$ 1,440	1	$ 695	-	-	-	-	1	$ 833	3	$ 2,968
Textiles	5	1,837	5	2,996	13	18,806	4	5,431	9	10,666	36	39,736
	5	$ 1,662	1	$ 54	4	$ 684	-	-	4	$ 2,969	14	$ 5,369
Electrical Equipment	1	60	3	900	3	4,612	3	3,969	2	2,201	12	11,742
	-	-	2	$ 137	-	-	-	-	2	$ 1,214	4	$ 1,351
Paper	-	-	1	140	2	330	-	-	3	1,850	6	2,320
	-	-	-	-	-	-	-	-	-	-	-	-
Clothes, shoes	-	-	2	257	1	100	1	300	7	4,314	11	4,971
	-	-	1	$ 7	-	-	-	-	1	$ 260	2	$ 267
Wood, Furniture	1	43	1	24	1	45	4	6,702	2	1,195	9	8,009
	-	-	-	-	-	-	1	$ 138	-	-	1	$ 138
Beverages	-	-	-	-	-	-	-	-	3	18,017	3	18,017
	-	-	-	-	-	-	-	-	1	$ 323	1	$ 323
Hides and Leathers	-	-	-	-	-	-	-	-	1	1,600	1	1,600
	-	-	-	-	-	-	-	-	-	-	-	-
Miscellaneous	-	-	-	-	1	60	1	49	4	2,700	6	2,809
	-	-	-	-	1	49	-	-	-	-	1	$ 49
Total NCr$	22	3,892	30	13,574	60	47,251	48	47,508	50	57,529	210	169,754
Total US$	7	$ 3,235	10	$ 1,743	16	$ 3,240	3	$ 180	11	$ 6,317	47	$ 14,715

NB: Numbers are numbers of operations (not numbers of clients). Simultaneous loans in NCr$ and US$ are counted as two operations.

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BANCO DO NORDESTE DO BRASIL S.A.

Breakdown of Industrial Term Loans Committed by Sector of Activity

B. In NCr$ 1,000 at 1968 prices*/US$ converted at 3.830

Sector	1964		1965		1966		1967		1968		Total		
	No.	Amount	No.	Amount	No.	Amount	No.	Amount	No.	Amount	No.	Amount	%
Non-metallic minerals	4	754	5	4,146	13	11,056	5	7,601	2	1,187	29	24,744	8.5
Metallurgical	8	4,522	7	6,627	20	20,702	13	16,707	8	8,311	56	56,869	19.5
Food Products	1	174	8	3,031	13	11,430	10	4,232	6	1,674	38	20,541	7.0
Chemicals	4	7,356	4	12,580	4	3,620	9	10,194	6	9,751	27	43,501	14.9
Textiles	10	12,747	6	6,831	17	32,653	4	6,745	13	22,039	50	81,015	27.8
Electrical Equipment	1	208	5	2,515	3	7,365	3	4,929	4	6,852	16	21,869	7.5
Paper	-	-	1	310	2	527	-	-	3	1,850	6	2,687	0.9
Clothes, Shoes	-	-	3	595	1	160	1	373	8	5,308	13	6,436	2.2
Wood, Furniture	1	149	1	53	1	72	5	8,852	2	1,195	10	10,321	3.5
Beverages	-	-	-	-	-	-	-	-	4	19,255	4	19,255	6.6
Hides and Leather	-	-	-	-	-	-	-	-	1	1,601	1	1,601	0.6
Miscellaneous	-	-	-	-	2	284	1	61	4	2,700	7	3,045	1.0
Total	29	25,910	40	36,688	76	87,869	51	59,694	61	81,723	257	291,884	100.0

* General Price Index determined by Getulio Vargas Foundation.

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ANNEX 7
Appendix 4b

BANCO DO NORDESTE DO BRASIL S.A.

Breakdown of Industrial Term Loans Committed According to Size

(in NCr$ 1,000 at 1968 prices*/US$ converted at 3.830)

	1964		1965		1966		1967		1968		Total		
	No.	Amount	No.	Amount	No.	Amount	No.	Amount	No.	Amount	No.	Amount	%
Up to NCr$ 50,000	2	55	1	27	1	34	3	50	-	-	7	166	0.1
50,001 to 100,000	-	-	3	196	5	401	7	508	4	335	19	1,440	0.5
100 001 to 500,000	13	2,939	13	3,477	28	6,924	14	4,042	17	5,386	85	22,768	7.8
500,001 to 1,000,000	5	3,484	11	7,820	15	10,893	9	6,096	16	12,462	56	40,755	14.0
1,000,001 to 5,000,000	8	13,896	11	20,083	25	55,541	17	42,704	22	46,123	83	178,347	61.1
more than 5,000,000	1	5,515	1	5,045	2	13,933	1	6,200	2	17,417	7	48,110	16.5
Total	29	25,889	40	36,648	76	87,726	51	59,600	61	81,723	257	291,586	100.0

* General Price Index determined by Getulio Vargas Foundation.

NB: Totals differ slightly from totals of other tables because calculations were based on the preliminary 1968 inflation rate of 24.0% (the final figure was 24.2%).

ANNEX 7
Appendix 5

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BANCO DO NORDESTE DO BRASIL S.A.

Regional Distribution of Industrial Term Loans Committed

A. In NCr$ 1,000 at current prices/US$ 1,000

State	1964 No.	1964 Amount NCr$1,000	1964 Amount US$1,000	1965 No.	1965 Amount NCr$1,000	1965 Amount US$1,000	1966 No.	1966 Amount NCr$1,000	1966 Amount US$1,000	1967 No.	1967 Amount NCr$1,000	1967 Amount US$1,000	1968 No.	1968 Amount NCr$1,000	1968 Amount US$1,000	Total No.	Total Amount NCr$1,000	Total Amount US$1,000
Alagoas	2	236	587	2	86	88	2	2,050	-	-	-	-	-	-	-	6	2,372	675
Bahia, of which	7	1,014	819	6	2,719	694	10	5,875	876	9	14,923	-	18	21,992	1,097	50	46,523	3,486
a) Salvador	2	700	759	3	2,310	694	10	5,875	876	4	9,119	-	10	6,840	774	29	24,844	3,103
b) Other Bahia	5	314	60	3	409	-	-	-	-	5	5,804	-	8	15,152	323	21	21,679	383
Ceara, of which	5	831	-	8	1,256	30	20	6,018	968	12	2,385	138	14	14,524	871	59	25,014	2,007
a) Fortaleza	3	415	-	6	776	30	14	2,491	253	10	1,881	138	12	13,953	871	45	19,516	1,292
b) Other Ceara	2	416	-	2	480	-	6	3,527	715	2	504	-	2	571	-	14	5,498	715
Maranhao	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Minas Gerais	-	-	-	-	-	-	-	-	-	-	-	-	1	1,300	-	1	1,300	-
Paraiba	6	487	207	3	1,540	-	5	3,587	-	5	2,112	38	-	-	-	19	7,726	245
Pernambuco, of which	4	677	1,573	15	6,659	319	30	27,078	1,195	21	27,442	4	23	18,051	3,258	93	79,907	6,349
a) Recife	4	677	1,573	7	3,044	83	14	11,174	450	14	19,192	4	18	14,944	3,258	57	49,031	5,368
b) Other Pernambuco	-	-	-	8	3,615	236	16	15,904	745	7	8,250	-	5	3,107	-	36	30,876	981
Piaui	1	29	-	-	-	-	1	36	-	2	168	-	1	600	-	5	833	-
Rio Grande do Norte	2	133	-	2	118	234	6	994	42	1	430	-	4	1,062	1,091	15	2,737	1,367
Sergipe	2	435	49	4	1,196	378	2	1,613	159	1	48	-	-	-	-	9	3,342	586
Total	29	3,892	3,235	40	13,574	1,743	76	47,251	3,240	51	47,508	180	61	57,529	6,317	257	169,754	14,715

B. In NCr$ at 1968 prices*/US$ converted at 3.830

State	1964 No.	1964 Amount	1965 No.	1965 Amount	1966 No.	1966 Amount	1967 No.	1967 Amount	1968 No.	1968 Amount	Total No.	Total Amount	%
Alagoas	2	3,068	2	527	2	3,274	-	-	-	-	6	6,869	2.4
Bahia, of which	7	6,659	6	8,670	10	12,737	9	18,534	18	26,194	50	72,794	24.9
a) Salvador	2	5,339	3	7,766	10	12,737	4	11,326	10	9,805	29	46,973	16.1
b) Other Bahia	5	1,320	3	904	-	-	5	7,208	8	16,389	21	25,821	8.8
Ceara, of which	5	2,837	8	2,892	20	13,318	12	3,491	14	17,860	59	40,448	13.8
a) Fortaleza	3	1,442	6	1,831	14	4,947	10	2,865	12	17,289	45	28,374	9.7
b) Other Ceara	2	1,445	2	1,061	6	8,371	2	626	2	571	14	12,074	4.1
Maranhao	-	-	-	-	-	-	-	-	-	-	-	-	
Minas Gerais	-	-	-	-	-	-	-	-	1	1,300	1	1,300	0.5
Paraiba	6	2,435	3	3,405	5	5,729	5	2,768	-	-	19	14,387	4.9
Pernambuco, of which	4	8,376	15	15,945	30	47,820	21	34,098	23	30,529	93	136,768	46.9
a) Recife	4	8,376	7	7,048	14	19,568	14	23,852	18	27,422	57	86,266	29.6
b) Other Pernambuco	-	-	8	8,897	16	28,252	7	10,246	5	3,107	36	50,502	17.3
Piaui	1	101	-	-	1	58	2	209	1	600	5	968	0.3
Rio Grande do Norte	2	462	2	1,157	6	1,748	1	534	4	5,240	15	9,141	3.1
Sergipe	2	1,872	4	4,092	2	3,185	1	60	-	-	9	9,209	3.2
Total	29	25,910	40	36,688	76	87,869	51	59,694	61	81,723	257	291,884	100.0

* General Price Index determined by Getulio Vargas Foundation

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BANCO DO NORDESTE DO BRASIL S.A.

Flow of Applications for Industrial Lending 1/

(at current prices)

	No.	NCr$ 1,000		US$1,000	
1966					
Under study beginning of year	15		4,932		4,494
received during year	114		86,721		25,181
processed during year	91		55,912		10,016
of which a) approved	74	50,052		5,435	
b) rejected	4	739		-	
c) returned to applicants 2/	13	5,121		4,581	
1967					
Under study beginning of year	38		35,740		19,659
received during year	166		146,713		15,434
processed during year	134		76,679		18,030
of which a) approved	119	66,238		17,874	
b) rejected	4	2,594		-	
c) returned to applicants 2/	11	7,847		156	
1968					
Under study beginning of year	70		117,350		18,519
received during year	163		201,992		24,061
processed during year	145		149,711		17,644
of which a) approved	111	112,215		7,539	
b) rejected	15	16,260		5,576	
c) returned to applicants 2/	19	21,237		4,529	
1969 (January - September)					
Under study beginning of year	88		164,919		21,304
received during first quarter	26		40,730		10,971
received during 2nd and 3rd quarter	21		48,856		4,768
processed during period	50		77,131		10,537
of which a) approved	4	200		995	
b) rejected	9	11,482		108	
c) returned to applicants 2/	37	65,449		9,434	
under study as at 9/30/1969 3/	85	171,396		25,462	

NB: Amounts may not add up because in some cases changes in the loan amount occur while projects are under study.

1/ Including basic services and loans to State Development Banks. Figures do not include subsequent increases of loans due to price increases.

2/ Projects not submitted to BNB's Board because they are not eligible for BNB financing under BNB's general loan conditions or because the applicant did not pursue the project or changed it substantially.

3/ Of which 74 applications totalling NCr$141,506,000 plus US$25,462,000 for private industry and 11 applications totalling NCr$29,890,000 for basic services.

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BANCO DO NORDESTE DO BRASIL S.A.

Liquidity Formula

1. BNB's maximum exposure in long-, medium- and short-term loans is limited by the following formula which was adopted by BNB's Board as part of the institution's 1970 program of operations:

A. Long-term loans (with an initial maturity of more than two years) shall not exceed the aggregate of:

a. 100 percent of BNB's capital and reserves, less the portion invested in fixed assets.

b. 100 percent of the Federal Tax Revenues deposited with BNB by the Government (see paragraph 37 of the Report).

c. 100 percent of the dividends on the Government's holdings of BNB's shares (see paragraph 35 of the Report).

d. 100 percent of BNB's long-term borrowings.

e. 23 percent of the 34/18 deposits (see paragraph 41 of the Report).

f. 20 percent of ordinary demand and term deposits.

g. 30 percent of other liabilities.

B. Medium-term loans (with an initial maturity of more than six months up to two years) shall not exceed the aggregate of:

a. any balance of the resources listed under A and not used for long-term loans.

b. 17 percent of the 34/18 deposits.

c. 10 percent of ordinary demand and term deposits.

d. 20 percent of other liabilities.

C. Short-term credit shall not exceed the aggregate of:

a. any balances of the resources listed under A and B and not used for long- and medium-term loans.

b. 47 percent of the 34/18 deposits.

c. 50 percent of ordinary demand and term deposits.

d. 30 percent of other liabilities.

2. According to this formula, BNB's liquid funds and sundry short-term assets would correspond always to at least:

a. 13 percent of the 34/18 deposits.

b. 20 percent of ordinary demand and term deposits.

c. 20 percent of other liabilities.

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BANCO DO NORDESTE DO BRASIL S.A.

Balance Sheets 1964 - June 30, 1969

(in NCr$ 1,000, at current prices)

ASSETS, as at December 31,	1964		1965		1966		1967		1968		June 30, 1969 (provisional)	
Liquid Assets												
Cash	1,423		2,901		4,685		4,631		9,879		4,752	
Banco do Brasil current account	13,952	15,375	76,961	79,862	168,016	172,701	22,106	26,737	59,847	69,726	40,895	45,647
Short-term Assets												
Banco do Brasil compulsory deposit	4,141		19,078		21,432		32,621		36,867		39,457	
Sundry debtors	5,444		5,591		11,025		17,157		131,242		139,029	
Treasury bonds with monetary correction	-		-		65,341		85,807		12,911		14,141	
Other marketable securities	1	9,586	30,032	54,701	6	97,804	130,008	265,593	99,993	281,013	133,023	325,650
Loans Outstanding and Bills Discounted												
Mining and manufacturing ST[1]	35,038		61,687		81,507		130,495		22,238		31,185	
" " " LT	10,279		31,494		75,480		119,951		170,748		205,521	
States, municipalities, public utilities ST	-		-		5,647		31,967		55,727		78,161	
" " " " LT	659		10,391		25,644		40,135		76,915		100,628	
Financial institutions ST	-		-		-		-		-		-	
" " LT	-		-		-		807		16,441		22,832	
Agriculture and cooperatives ST[1]	1,871		5,763		10,949		9,440		-		-	
" " " MT	6,285		14,358		36,606		75,563		106,176		112,023	
" " " LT	5,453		13,860		30,880		78,381		168,228		199,410	
Commerce and others ST[1]	14,946		21,146		28,448		43,438		243,009		235,150	
" " " LT	59	74,590	143	158,842	1,020	296,181	4,258	534,435	9,504	868,986	11,277	926,187
(Total ST)	(51,855)		(88,596)		(126,551)		(215,340)		(320,974)		(344,496)	
(Total MT)	(6,285)		(14,358)		(36,606)		(75,563)		(106,176)		(112,023)	
(Total LT)	(16,450)		(55,888)		(133,024)		(243,532)		(441,836)		(539,668)	
Fixed Assets												
Equity investments	131		390		406		583		969		1,140	
Buildings	87		679		1,421		6,039		9,352		10,959	
Equipment	698		1,334		1,787		4,208		9,623		11,801	
less depreciation	- 104	812	- 205	2,198	- 384	3,230	- 1,006	9,824	- 2,077	17,867	- 2,808	21,092
Total		100,363		295,603		569,916		836,589		1,237,592		1,388,576
LIABILITIES												
Demand and Short Term Deposits												
34/18 deposits pending disbursement	-		927		7,194		30,980		45,444		45,885	
Other private	4,923		14,669		29,130		29,081		49,377		66,623	
Government sector	16,448	21,371	23,701	39,297	24,584	60,908	22,613	82,674	39,453	134,274	51,402	163,910
Term Deposits (6 months and more)												
34/18 deposits (pending SUDENE approval)	45,635		186,478		369,228		541,592		672,119		741,321	
Other private	343		100		67		21		21		314	
Federal Government (non-repayable deposits)	11,532		24,107		24,311		31,687		24,721		-	
Other Government sector	314	57,824	181	210,866	197	393,803	216	573,516	-	696,861	-	741,635
Sundry creditors	7,591	7,591	7,849	7,849	32,043	32,043	29,122	29,122	140,315	140,315	143,779	143,779
Long-term borrowings (Inter-American Development Bank)	6,016	6,016	20,442	20,442	29,888	29,888	44,039	44,039	64,480	64,480	74,142	74,142
Net Profit before distribution	3,496	3,496	9,053	9,053	37,198	37,198	37,213	37,213	42,407	42,407	35,510	35,510
Equity												
Share capital	100		3,800		3,800		15,200		15,200		140,000	
Subscribed capital increase	2,166		-		-		44,800		69,843		-	
less: not yet paid in	- 48		- 6		- 2		- 44,800		- 33,341		- 12,600	
Legal reserve	95		253		682		2,507		4,326		6,447	
Other reserves	1,752		4,049		11,006		51,506		102,217		94,716	
Employees' fund	-	4,065	-	8,096	590	16,076	812	70,025	1,010	159,255	1,037	229,600
Total		100,363		295,603		569,916		836,589		1,237,592		1,388,576
Same at 1968 prices		348,661		653,578		910,156		1,039,044		1,237,592		1,266,[illegible]

1/ Following a change in the Central Bank's accounting regulations during 1968, certain short-term operations previously shown under "Mining and manufacturing" and "Agriculture" are now shown as credits to "Commerce and others".

Abbreviations
ST - Short Term (up to 6 months)
MT - Medium Term (6 to 24 months)
LT - Long Term (two years and more)

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BANCO DO NORDESTE DO BRASIL S.A.

Profit and Loss Statements, 1964 - June 30, 1969

(in NCr$ 1,000, at current prices)

	1964	1965	1966	1967	1968	First Half of 1969[1]
Interest on loans and discounts	5,018	10,876	21,651	37,408	67,058	43,548
Commissions	3,807	8,595	17,217	28,494	51,153	30,196
Income on short-term assets	0	13	15,005	6,753	5,179	5,739
Other operational income	438	674	326	1,084	3,577	1,810
Total Revenues	9,263	20,158	54,199	73,739	126,967	81,293
Interest paid	479	1,068	988	1,418	2,897	1,450
Commissions paid	418	937	1,395	2,170	3,080	1,678
Administrative expenses	4,835	8,955	14,379	30,034	68,902	36,815
Depreciation of fixed assets	31	102	183	628	1,100	743
Total Expenses	5,763	11,062	16,945	34,250	75,979	40,686
Gross Income	3,500	9,096	37,254	39,489	50,988	40,607
Losses on loans	- 6	- 54	- 74	- 2,330	-10,316	- 5,976
Adjustments	+ 2	+ 10	+ 18	+ 54	+ 1,735	+ 879
Net Income	3,496	9,052	37,198	37,213	42,407	35,510
Plus: monetary correction directly credited to equity accounts	-	764	16	15,916	20,075	17
Total Net Earnings	3,496	9,816	37,214	53,129	62,482	35,527
Same at 1968 prices	12,145	21,703	59,431	65,986	62,482	32,926

1/ Provisional figures

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ANNEX 11

BANCO DO NORDESTE DO BRASIL S.A.

Allocation of Net Income, 1964 - first half of 1969[1]

(in NCr$ 1,000, at current prices)

	1964	1965	1966	1967	1968	First half of 1969
Net Income	3,496	9,052	37,198	37,213	42,407	35,510
Plus: Adjustment in dividend payment for 1965			222			
			37,420			
Less: Allocations made by Management						
a) paid out						
Staff bonus[2]	1,005	890	1,344	980	-	5,430
Directors' profit participation	-	-	-	183	173	119
Dividends	-	-	-	1,900	3,040	1,325
	1,005	890	1,344	3,063	3,213	6,874
b) retained						
Legal Reserve	158	429	1,825	1,819	2,120	1,357
Special Fund for Risks of Drought	645	1,324	4,348	4,473	4,241	2,715
Reserve for Risks	227	859	3,650	3,638	4,241	2,715
Special Reserve	-	-	-	-	-	8,361
	1,030	2,612	9,823	9,930	10,602	15,148
Put at disposal of General Assembly	1,460	5,550	26,253	24,220	28,592	13,488[3]
Less: Allocations made by General Assembly						
a) paid out						
Directors' bonus	25	66	99	-	-	
Dividends	12	455	760	-	- 1,216[4]	
6% p.a. interest on payments received from subscribers of new shares	-	-	-	-	430	
	37	521	859	-	- 786	
b) retained						
Special Fund for Rural Risks	317	859	3,650	-	-	
Special Fund for Direct Investments	200	200	1,000	5,000	3,000	
Fund for Assistance of Employees	107	270	474	220	578	
Fund for Social Charges	100	200	270	-	-	
Reserve for Capital Increase	-	2,200	10,000	15,000	25,800	
Special Reserve for Construction of New Head Office	700	1,300	10,000	4,000	-	
	1,424	5,029	25,394	24,220	29,378	

1/ Totals may not add up due to rounding

2/ From July 1, 1967 to December 31, 1968, staff bonuses were charged to administrative expenses

3/ Carried forward on profit and loss account

4/ The dividend fixed at 20% by BNB's Management was reduced to 12% by the General Assembly

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BANCO DO NORDESTE DO BRASIL S.A.

Projected Balance Sheets, 1969-1973, Compared with 1968

(in NCr$1,000, at current prices)

	Actual 1968	1969	1970	1971	1972	1973
Assets						
Cash and short-term deposits	69,726	70,000	75,000	75,000	80,000	80,000
Short-term investments	112,904	47,200	96,900	133,311	149,225	183,585
Receivables, accrued income etc.	168,042	140,000	100,000	80,000	90,000	90,000
Total short-term assets	350,672	257,200	271,900	288,311	319,225	353,585
Outstanding loans:						
Domestic currency	803,950	1,121,639	1,439,000	1,776,806	2,024,772	2,285,748
Foreign currency	65,035	80,000	120,000	200,000	400,000	600,000
Total loans	868,985	1,201,639	1,559,000	1,976,806	2,424,772	2,885,748
Equity investments	969	1,000	1,000	1,000	1,000	1,000
Fixed assets (net)	16,898	21,153	28,653	35,453	41,553	46,953
Total fixed assets	17,867	22,153	29,653	36,453	42,553	47,953
Total Assets	1,237,524	1,480,992	1,860,553	2,301,570	2,786,550	3,287,286
Liabilities and Equity						
34/18 deposits	672,119	745,000	745,000	710,000	660,000	600,000
Other deposits, accounts payable and sundry creditors	302,322	345,939	582,250	839,148	981,396	1,090,844
Total deposits and short-term liabilities	974,441	1,090,939	1,327,250	1,549,148	1,641,396	1,690,844
Foreign currency borrowings	64,480	80,000	120,000	200,000	400,000	600,000
Domestic currency borrowings (rediscounts)	153	4,000	4,000	148	146	144
Total long-term funds	64,633	84,000	124,000	200,148	400,146	600,144
Share capital	15,200	140,000	140,000	140,000	140,000	140,000
Reserves, unappropriated surplus	183,250	166,053	269,303	412,274	605,008	856,298
Total equity	198,450	306,053	409,303	552,274	745,008	996,298
Total Liabilities and Equity	1,237,524	1,480,992	1,860,553	2,301,570	2,786,550	3,287,286
Debt/equity ratio	5.2:1	3.8:1	3.5:1	3.2:1	2.7:1	2.3:1

IBRD/DFC
December 9, 1969

Assumptions:

1. Forecasts of 34/18 deposits are the same as in Annex 6. They are based on projected income tax revenues and a gradually decreasing share of the Northeast as against other investment incentive schemes.

2. Other deposits, accounts payable and sundry creditors (including non-repayable deposits of the Federal Government) have been assumed to increase only moderately (by 14%, in nominal terms) during 1969. Expected growth rates for 1970 and 1971 are substantial (68% and 44% respectively); BNB hopes to achieve these increases through advertising campaigns. Projected increase for 1972 is 17%, and for 1973, 11%.

3. Domestic currency loans have been tailored to available resources, on the assumption that there would be sufficient demand for BNB loans.

4. Outstanding foreign currency loans are for industry and basic services during 1969 and 1970; beginning 1971, BNB expects to make foreign currency loans for agriculture, and by the end of the forecast period agriculture loans are expected to account for about half of the total outstanding foreign currency loans.

5. Outstanding loans are net after direct write-off of doubtful loans.

6. Assumed inflation rates are 20% during 1969, 15% during 1970 and 10% during later years.

IBRD/DFC

December 18, 1969

BANCO DO NORDESTE DO BRASIL S.A.

Projected Statements of Income, 1969-1973, Compared with 1968

(in NCr$1,000, at current prices)

	Actual 1968	1969	1970	1971	1972	1973
Income						
Income from loans -						
Interest	67,058	111,138	156,650	200,130	253,920	317,400
Commitment charge, other fees, commissions, etc.	51,153	55,616	64,190	81,950	104,010	128,440
Income from short-term investments, deposits and other income	10,491	12,032	20,661	23,150	26,700	30,800
Total Income	128,702	178,786	241,501	305,230	384,630	476,640
Expenses						
Interest and commitment charges on borrowings	2,897	3,983	4,112	6,028	11,700	18,300
Commissions	3,080	3,479	4,408	5,550	8,680	11,245
Salaries and other personnel expenses	(	56,429	79,182	93,418	106,199	121,208
Other administrative and general expenses	(68,902 (	27,702	26,948	32,962	40,316	48,896
Provision for doubtful loans and investments	10,316	8,361	9,100	11,500	14,500	18,300
Depreciation of fixed assets	1,100	1,770	2,500	3,200	3,900	4,600
Total Expenses	86,295	101,724	126,250	152,658	185,295	222,549
Profit before tax	42,407	77,062	115,251	152,572	199,335	254,091
Provision for tax 1/	-	2,235	4,301	4,301	4,301	4,301
Net Profit	42,407	74,827	110,950	148,271	195,034	249,790
Appropriations						
Dividends	2,427	9,425	16,800	16,800	16,800	16,800
Reserves	39,980	65,402	94,150	131,471	178,234	232,990
	42,407	74,827	110,950	148,271	195,034	249,790
Earnings (before interest, taxes, and provisions for doubtful loans and investments) as % of average total assets	5.4	6.6	7.7	8.2	8.9	9.6
Net profit as % of average total assets	4.1	5.5	6.6	7.1	7.7	8.2
Net profit as % of average equity	28.0	29.7	31.0	30.8	30.1	28.7

1/ BNB pays income tax only on dividend distributions to shareholders other than the government. For 1968, the amount (which is negligible) is included in general expenses.

IBRD/DFC
December 9, 1969

Assumptions:

1. Income from loans (interest and commission) has been assumed to remain at the present level of 15.9% to 16.8%. This position includes earnings on account of monetary correction of the principal of indexed local currency loans. Considering the proposed increases in BNB's lending rates for industrial loans, the assumption seems conservative even if inflation is levelling off to rates of 10% p.a.

2. Expenses for interest and commitment charges on borrowings will average only 3.7 to 4.1% of average outstanding long-term borrowings during the projection period. Although BNB has had access to low-cost borrowings in the past for its basic services program, actual average cost of borrowings will probably be higher than estimated by BNB, and additional expenses which may reach up to NCr$ 10 to 12 million by 1973 are likely to arise in this position.

3. Administrative expenses, including personnel expenses have been assumed to increase by 22% during 1969, by 26% during 1970, 19% during 1971 and 16% during 1972 and 1973. Considering that the cut in staff hours which was made in September 1969 will result in a sizeable decrease (in real terms) of administrative expenses, these assumptions appear conservative.

4. Provisions for doubtful loans and investments have been assumed at a rate of 0.6% p.a. of the year-end portfolio for 1970 and later years. They are not comparable to the higher 1968 and 1969 figures which reflect a change in policies (see para. 72).

5. Dividend distributions have been assumed at the rate of 12% p.a.

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December 18, 1969

BANCO DO NORDESTE DO BRASIL S.A.

Projected Limits of Exposure in Long, Medium and Short Term Lending Operations

(in NCr$ 1,000, at current prices)

The application of BNB's liquidity formula (see Annex 8) to the liabilities part of BNB's projected balance sheets (see Annex 12) results in the following limits of exposure:

Year ending December 31	Actual 1968	1969	1970	1971
Long-term loans	494,375	625,735	835,450	1,144,098
Medium-term loans	156,351	178,541	201,875	220,615
Short-term loans	426,035	488,525	586,275	658,274
Total exposure in loans	1,076,761	1,292,801	1,623,600	2,022,987
Minimum liquid funds as per formula	142,896	166,038	207,300	242,130
Fixed assets as per projections	17,867	22,153	29,653	36,453
Total of balance sheets	1,237,524	1,480,992	1,860,553	2,301,570

N.B. For the purpose of this calculation, the position "other deposits, accounts payable and sundry creditors" was broken down as follows:

	1969	1970	1971
Non-repayable Government deposits	-	30,000	90,000
Ordinary demand and term deposits	172,969.5	352,250	499,148
Accounts payable and sundry creditors	172,969.5	200,000	250,000
	345,939.0	582,250	839,148

IBRD/DFC

December 19, 1969

SUPPLEMENTARY REPORT

THE NORTHEAST INDUSTRIALIZATION PROGRAM

PREFATORY NOTE

This report is the work of an industrial policies group attached to the Economic Mission which visited Brazil in Spring 1969. It was prepared to supplement the appraisal report of the Mission to the Bank of the Northeast. Members of the industrial-policies group were: Mr. Louis J. Walinsky (Consultant), Chief; Mrs. Helen Hughes, and Mr. Otto Wadsted, Consultant.

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THE NORTHEAST INDUSTRIALIZATION PROGRAM

I. Historical and Economic Background

1. The Northeast, comprising 9 out of Brazil's 21 states, about 1.5 million out of Brazil's 8.6 million sq.Km., and about 27 million out of Brazil's total of approximately 90 million population, has been a national problem since the long and punishing drought of 1877-79. The First National Commission of Enquiry into the problems of the Northeast was established at that time. Subsequent droughts, at an average interval of 10 years or so, and lasting one to three years, resulted in new commissions and agencies for dam building, public works and relief. In 1934, constitutional provision was made for allocating to the Northeast a minimum of 4% annually of Federal revenues. The San Francisco Valley Commission was established in 1948, and the Banco do Nordeste do Brasil (BNB) in 1954. Finally, the Superintendency for the Development of the Northeast (SUDENE) was created in 1959.

2. All through this period the Northeast was characterized by levels of output and employment far lower than those prevailing in the rest of Brazil. Income per capita was roughly one-half the national average.[1/] Large scale out-migration from the region was persistent. In consequence, the rate of population growth has been about one-third less than the national average.

3. As recently as 1960, agriculture, forestry and fisheries accounted for 46% of the region's income, as compared to 28% for Brazil as a whole. Industry (including mining, construction and utilities, as well as manufacturing) contributed only 11% to regional income, as compared to 26% for Brazil as a whole.[2/] As of 1950, some 71% of the region's labor force was engaged in agriculture, as compared to 52% in the rest of Brazil.[3/]

4. The structure of manufacturing in the region also lagged that of the rest of the country. As recently as 1958, nearly three-fourths of gross value added in manufacturing industries in the Northeast was accounted for by so-called traditional industries producing almost entirely for the consumer market. Nearly 70% of the total was concentrated in foods and beverages and textile and clothing production. Of the other industries, only chemicals contributed significantly to the total. Output in the growth-oriented capital goods and intermediate goods industries (other than chemicals) was negligible. In contrast, on a national scale, traditional industries accounted for less than 45% of total value added. While less

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1/ Stefan H. Robock, Brazil's Developing Northeast, Table 2.1

2/ Robock, Table 3.4

3/ Robock, p. 60

diversification in a region's industrial structure is clearly compatible with the advantages of both specialization and industrial development, in the case of the Northeast it was also associated with far lower relative levels of output and income per capita, and it was hence regarded as constituting in itself a major aspect of the Northeast's development problem. These data are shown in Table 1.

5. The development and output of the regional economy and of its manufacturing industries had thus lagged behind that of the nation. In addition, as late as the 1950's it was falling even further behind in its shares in manufacturing output, value-added and employment, as shown in Table 2. The Northeast share in manufacturing output fell from 10.1 percent in 1949 to 6.9 percent in 1958. Its share in gross value-added fell from 10.6 percent to 6.5 percent at the same time. And its share in manufacturing employment fell from 16.7 percent to 11.0 percent. Even more significantly, employment in Northeast manufacturing declined in absolute terms, while that for Brazil as a whole experienced modest gains. The employment decline in the Northeast, to be sure, resulted from productivity gains which rose faster than did the value-added in production. Indeed, value-added per worker increased faster in the Northeast than in Brazil as a whole, rising from 55.9 percent to 59.3 percent of the national average from 1949 to 1958. However, in a region plagued by high level unemployment, this was at best small consolation. The years 1958-1966, in contrast, show improvements in Northeast manufacturing output and value-added growth, some increase in employment, and a relative maintenance of the Northeast share in national totals. Even though the SUDENE operation had fairly gotten into operation only a couple of years before, its effects were already becoming evident.

6. These circumstances of lagging growth, development and income levels in the Northeast, together with a growing social and political unrest, underlie recent government policy for the Northeast. With the creation of the Bank of the Northeast, policy emphasis shifted from the earlier "fight the drought" to a more positive development approach. Because national and regional accounts became available at about the same time, the sharp disparity in per capita income levels, and measures to reduce them, became increasingly the focus of public attention and policy. The extremely severe 1958 drought was shortly followed by the famous Furtado Report,1/ which showed the need for a more comprehensive program for the Northeast, and by the creation of SUDENE.

II. SUDENE

7. The new agency was granted broad authority to supplement as well as control the activities of regional agencies previously created. In addition to substantial financial resources made available to it for public investment, it was empowered to administer important new incentives to private investment -- notably income tax and customs duty exemptions for industries, and preferential treatment with respect to foreign exchange allocations and rates. In 1961, a very powerful new incentive was added to these -- the 50 percent corporate income tax credit (34/18) for industrial investment in the Northeast.

1/ Grupo de Trabalho para o Desenvolvimento do Nordeste, Uma politica de desenvolvimento economico para o Nordeste, Imprensa Nacional, Rio, 1959.

8. Furtado's analysis had shown that the Northeast's terms of trade were deteriorating: its major (agricultural) products were exported in internationally competitive markets, while the manufactured goods it bought from the rest of Brazil were highly protected. Nevertheless, within the general framework of a comprehensive development objective, his principal emphases1/ were on increased irrigation, organized colonization and better land use in the coastal sugar strip. It may be that the political difficulties encountered by these objectives were largely responsible for the increasing emphasis placed on industrialization in the 1960's.

9. Writing on Brazil's goals for the Northeast in 1963, Robock stated that "to Brazil, the challenge of the Northeast is to accelerate economic and social development in the nation's most backward region, and thereby to reduce actual and potential social and political disorder." How much acceleration in growth, or what degree of reduction in regional per capita output and income disparities, or the specific contributions to be made towards the general goal by the several economic sectors, were not clear at that time, and remain unclear today. What is clear, however, is that SUDENE places major reliance on industrialization as an engine of modernization and growth. SUDENE's program from 1969-1973 states that "the industrial sector must represent in the long run a dynamic center which will permit regional growth with greater autonomy."2/ Industry, it states, should be mainly responsible for modernizing the regional economy, and for providing major support to continuing self-sustained growth.

10. The SUDENE program, it should be clear, embraces most public sector activities in the Northeast -- agriculture, natural resources, electric power, transport and communications, basic sanitation, education and training, housing, health and so on, as well as manufacturing industry. SUDENE plans for public investment include those activities and investments which are to be executed by Federal agencies, with which it coordinates, as well as those for which other regional agencies are responsible, under its supervision and (presumably) control.

11. The broad objectives of SUDENE's industrialization policy, while not clearly formulated, may perhaps be stated as the continued accelerated expansion of manufacturing (and related) investment, output and employment in the Northeast, and increasing diversification of the structure of this expanding output to achieve greater participation and balance in the intermediate and capital goods fields, until the pattern and economic contribution of manufacturing activity more closely approximate that of the rest of the country. In the absence of specific targets as to contribution to regional income, share in national output, investment, employment, and so on, "catching up" with the rest of Brazil or with national averages stands out as SUDENE's major industrialization objective for the Northeast.

1/ According to Hirschman's "Brazil's Northeast" in Journeys to Progress

2/ SUDENE, IV Plano Director, p. 106

12. Other and more specific objectives are visible in the criteria or point system SUDENE has established to help determine the extent to which tax credits (34/18) funds may contribute towards the non-loan financing of individual projects approved by it. The points accorded to these criteria may be considered to comprise a system of priorities for further industrial development. Within SUDENE's current system, higher priorities are accorded to industrial projects to be located in the poorest and least industrialized Northeast states. Projects which promise to absorb a large number of workers, and others which are considered "essential" to regional development, may also be accorded relatively high point counts. Essentiality here appears to be considered synonymous with structurally balanced industrial growth. (The highest point counts for the essentiality category are awarded to projects in the capital goods and basic intermediate goods, other intermediate goods and the consumer durables and textile fields, in that order.) Somewhat below these in point value are projects which will use a large proportion of regional inputs, and others which contribute towards national import substitution, while the lowest point counts are accorded to modernization and expansion programs involving productivity increases, to projects registered as "open capital" firms whose ownership is therefore somewhat dispersed, and to projects in which labor will be accorded some participation in profits. Details of the point system are shown in Chart A.

13. SUDENE's role in the industrial development of the Northeast is a major and dominant one. The availability of 34/18 tax credit and other incentives to industrial investment in the Northeast, all administered through SUDENE, appear to have virtually eliminated new industrial investment outside the SUDENE system. Firms with an income tax liability in substantial amount almost automatically take advantage of the opportunity to deposit half of this liability for possible investment in the Northeast, since the cost to them is zero. Industrial investment proposals thus flow to SUDENE for its consideration and approval. SUDENE's role as arbiter as to which projects will qualify for the various incentives offered, and in what degree, has placed it in a pivotal and controlling position. Projects to which it denies approval are almost automatically eliminated. Investors who lack 34/18 tax credits inevitably seek out those who have them to supplement their own resources. Taxpayers who have 34/18 credits will not invest their own resources in projects which lack SUDENE's approval for use of their tax credits.

14. The SUDENE role in industrial development thus embraces the review of investment intentions, the approval or disapproval of proposed industrial projects and the determination of relative priorities in accordance with which various kinds and amounts of incentives may be extended. While investment proposals originate with the private sector, the SUDENE role is more than that of the arbiter who determines whether these intentions are realized. Through this power it also stimulates, influences, and helps shape the investment intentions themselves.

15. The major incentive within the SUDENE arsenal resides in its power to permit the use of tax credits (34/18 funds) in either new or modernization and expansion of industrial projects in the Northeast. It may

permit the use of such funds in the case of individual projects in amounts up to a maximum of 75% of their non-loan financing. In cases where no loan financing is involved, therefore, this SUDENE power may result in a grant to an individual project of as much as 75% of the total capital required. In such a case, the minimum "own resources" financing requirement for a project would be 25%. Since the Bank of the Northeast may make a maximum loan of 50% of the total capital required to a SUDENE approved project, a 75% SUDENE approval for the use of 34/18 funds would, in such a case mean a subsidy of only 37.5% of the total capital required (.50 x .75). This would also reduce the "own resources" minimum equity requirement to 12.5% of the total (This subsidy element, it should be noted, is a subsidy to the project, but not necessarily a subsidy to its organizer or promoter. The organizer of a project may provide the "own resources" investment himself, while the 34/18 funds may be invested by others. The organizer-entrepreneur in such a case benefits in that he obtains equity capital which might otherwise not be available, but receives no subsidy.) A more detailed description of SUDENE's 34/18 regulations is presented in Appendix I.

16. This powerful incentive is supplemented by several others. The law grants partial or full income tax exemptions for at least ten years to all new manufacturing firms except those which SUDENE may consider "undesirable." Even firms which were in operation prior to 1963 are eligible for 50% exemptions up to 1978. Firms established between July 1963 and end of 1971 get the same 50% exemptions as do previously established firms in the same lines, for a period of 10 years. If, however, the new firm pioneers a product new to the regional industry, the tax exemption is increased to 100%. Through 1968, the 100% exemption had been accorded to 38 projects. In both cases, SUDENE may extend the exemption to 15 years, especially for firms locating in relatively backward areas. Approved projects are also eligible for loans from the Bank of the Northeast on terms which are concessiomary, both as to maturity and interest rate. Till recently, BNB term loans were extended at 12% plus 2% commission -- a sizeably negative interest rate. Even now, at 12% plus a monetary correction of 10%, the rate is still very low in real terms. Northeast industrial projects may also be accorded reductions or exemptions from import duties for capital equipment required (although this privilege is not restricted to Northeast investment). Finally, individual state governments offer additional incentives. Although the SUDENE incentives are well-known, relatively little is known about state government participation in the industrialization incentive program.

17. The Northeast states have added further incentives to those provided by the Federal Government and its agencies. The most important of these is partial exemption from the state value-added tax, the I.C.M. (imposto de circulacao de mercadorias). Firms can deposit up to 60 percent of the value of their I.C.M. liability in a State Development Bank in a special account in their own name. With the approval of state development councils, these funds can be used as "own capital" in investment projects introducing new industries or products which are considered of importance in improving the productivity and expanding the productive

capacity of the state's industrial sector. These deposits cannot be used during the first year of deposit, but during this first year the state banks will lend each depositor an amount up to 70 percent of his deposit, at an interest rate which is not to exceed 6 percent per year. On the other hand, the deposits must be used within two years after the first year; otherwise the funds revert to the state.

18. In most of the northeastern states investors may borrow varying percentages up to 80 percent of approved project cost from state banks, for new projects and for modernization or expansion of existing projects. State development companies or state investment companies may participate in the equity financing of a project by buying shares for later resale in capital markets. Such participation is in relation to the "own resources" component of 34/18 projects. This has enabled some investors to contribute as little as 6¼ percent of their own funds in 34/18 projects. Some state companies also offer to subscribe part of the 34/18 component in a project for later re-sale to 34/18 depositors, thus accelerating the funding of a project under construction. While the total value of such incentives is unknown, it is probably quite limited, because of the weak financing of the state banks and development companies.

III. The 34/18 Operation through 1968

19. The tax credit and resource transfer mechanism, beginning 1962, resulted in deposits of NCr 1,655 million (in current prices) by the end of 1968. Deposits have risen greatly since 1963. In constant values they more than doubled from 1963 to 1964 and 1964 to 1965. The average yearly increase has been about 25 percent since that time. While at the outset of this program SUDENE was the only beneficiary, its share in total tax credit deposits has declined markedly, from over 90 percent in 1964-1965 to approximately two-thirds in 1968. The SUDAM (Amazon region) share in fiscal incentives has been growing rapidly, and amounted to 23 percent of the total in 1968. The remaining 13 percent was accounted for in 1968 by three new priority sectors -- tourism, fishing and reforestation. Because of these new demands, SUDENE's annual 34/18 deposits, in constant values, increased only 39 percent from 1965 to 1968, and only 5 percent from 1967 to 1968. These data are shown in Table 3.

20. The proportion of tax paying firms which have become depositors under the fiscal incentives system has grown rapidly over the years. From negligible proportions in 1962, 1963, and 1964, this ratio grew rapidly, according to SUDENE, to 6.5 percent in 1965, 8.2 percent in 1966, 13.5 percent in 1967, and 23.1 percent as of March 1968. These accounted for a very large proportion of total corporate income tax liabilities. Nearly 80 percent of all 34/18 deposits in 1965 were made by Sao Paulo and Guanabara firms.1/ Two-thirds of such deposits during 1965 were accounted for by depositors of NCr 50,000, or over, and 29 percent

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1/ Hirschman, Industry Development in the Brazilian Northeast and the Tax Credit Mechanism of Article 34/18, Table 2 by depositors of NCr 500,000 or over.[1/] (Unfortunately, more recent data on these concentrations were not available.) Significantly, during the years 1966-1968, 34/18 deposits comprised more than 50 percent of corporate income tax collections net of the fiscal incentives, and amounted to nearly 35 percent of the Federal Government's cash deficit. These data are shown in Table 4.

21. Although SUDENE project approvals, in money terms, lagged behind SUDENE's 34/18 deposits for some years, approvals substantially exceeded deposits in 1967 and 1968. By the end of 1968, approvals in total approximated total deposits. Total disbursements by the end of 1968 were some 43 percent of approvals. Disbursements in 1968, at 316 million cruzeiros, were roughly three-fifths of deposits for that year. They are rather optimistically expected to exceed 600 million cruzeiros in 1969 (although the first quarter disbursement rate was far below this). These data are shown in Tables 5 and 5A.

22. It is appropriate at this point to present a picture of the industrial projects which have been approved by SUDENE. The description and analysis will embrace their number, value, kind, size and geographic distribution. It will present also the employment which SUDENE anticipates will be created by them, and analyze their financing, their prospective raw materials sources, markets and profits. Finally it will project the increased value-added in manufacturing, and the modified industry structure, in which they may be expected to result. Unfortunately the SUDENE data on some of these points are not as clear or integrated as might be desired. Different tables covering the same periods of time do not coincide in terms of the number of projects approved; neither is it clear in all cases whether the projects embrace manufacturing or industrial projects only, or whether they apply to some agricultural projects as well. Despite these inconsistencies and ambiguities, there is sufficient correspondence among the data to permit a fairly reliable portrait to be drawn.

23. By the end of 1968 over 600 projects with a total investment value of some 3.4 billion (1968) new cruzeiros had been approved. About three-fourths of these projects which had individually a total investment value of less than 5 million new cruzeiros accounted for less than one-fifth of the total investment. Projects with individual values of 10 million new cruzeiros and over, accounted for something less than 14 percent of the number of projects, and nearly 70 percent of the projected investment total. These data are shown in Table 6.

24. Data showing the distribution of approved projects by industrial branches and by geographic location are presented in Table 7. Some 17 percent of the projects are in the textile field, 16 percent in the food products and chemicals fields, 11 percent in the non-metallic minerals field and 9 percent in the metallurgical field. While these five fields account for some 70 percent of the total, the remaining projects are distributed relatively thinly over the 14 remaining industrial branches. In terms of geographic distribution, some 70 percent of the projects are concentrated in three states: Pernambuco, 33 percent; Bahia, 21 percent; and Ceara, 16 percent.

1/ Hirschman, Table 3

25. While 70 percent of the number of projects were located in Pernambuco, Bahia and Ceara, which account for 59 percent of the Northeast population, these states account for nearly 81 percent of the investment total projected. Seven-tenths of the total investment value is accounted for by four industrial branches; chemical industries, 27 percent; textiles, 17 percent; metal industries, 15 percent; and non-metallic minerals, 11 percent. These data are shown in Table 8.

26. Data on the number of jobs which are anticipated to be created by some 569 projects approved through 1968 are shown in Table 9. These data based, as are all the others, on the project proposals presented to the SUDENE, anticipate employment of some 112,000 workers. Of these, the heaviest concentrations are shown in the textile, food products, chemical, non-ferrous metal and metallurgical industries. The data show also the anticipated investment per man employed in the respective industry branches, and an average investment for all projects of some 30,000 new cruzeiros per employee. The average investment per worker is thus indicated to be some 7,500 dollars.[1/]

27. Investment of capital per worker may actually be somewhat higher. It was explained to the mission that SUDENE's employment creation figures, especially in the earlier years, included the then current employment in plants seeking SUDENE approval for modernization and expansion programs, on the theory that in the absence of such SUDENE assistance, they would be forced to shut down and release their workers. This suggests that newly created employment by these projects may be somewhat less than the 112,000 figure shown, and the average investment per man figure would be correspondingly higher. Even so, the SUDENE projects, assuming they had contributed only minimally to employment by 1966, would increase manufacturing employment in the Northeast by up to 50 percent.

28. Any attempt to measure the influence of the 34/18 operation on the Northeast's economy must take into account the fact that less than 30 percent of the projects approved had been completed by the end of 1968. Data covering some 645 projects show them to be distributed between 422 new projects and 223 modernization projects. Of the former category, 155 had been completed by the end of 1968, while 151 were **under construction.** Of the 223 modernization projects, only 32 had been completed, while 55 were under construction and 136 had not yet been started. These data, geographically distributed, are shown in Table 10.

29. The programmed composition of the total investment financing involved in some 645 projects is shown, year by year, in Table 11. Foreign loan financing and official bank loans have supplemented 34/18 funds and firms' own resources in important degree, accounting most recently for about one-fifth and one-sixth of the total financing projected, respectively. As the program progressed, 34/18 funds have played an increasingly important role in total project financing, exceeding 45 percent in 1966 and thereafter.

1/ Current comparable figures for Singapore, Malaysia and Thailand would be between $6,000-8,000 and for Colombia, $7,000.

Firms' own resources, as a share of total, declined to 20.6 percent in 1968. Perhaps one-quarter of this own resources equity input originated abroad. This foreign financing input was in addition to the foreign loan financing shown in the table.

30. Considerable criticism and even more questions have been voiced concerning the economic soundness of the Northeast industrialization policy and the 34/18 scheme. Much of this has been based on the assumption that new industrial projects in the Northeast would rely mainly on materials transported back to the rest of Brazil to market. The conclusion frequently drawn has been that the projects themselves were unsound and, in the absence of subsidy, not economically viable. It should be clear that a heavy reliance on markets outside the Northeast would not in themselves demonstrate the unsoundness of Northeast industrial projects. The ability to sell competitively in other than the regional market would normally demonstrate the contrary. The allegations rest, however, not on these facts; their logic rests rather on the assumption that the Northeast market is inadequate even for subsidized industries, and that these can exist only by selling their subsidized products in the rest of Brazil. The mission has therefore devoted some time to an analysis of the detailed data provided by SUDENE on a large number of projects. These do not support or confirm these widely prevalent suspicions.

31. Examination of the data provided by 486 project proposals discloses that 46 percent of the total material inputs costs anticipated will be met from the Northeast itself, while some 41 percent of material inputs, it is anticipated, will be accounted for by the rest of Brazil, and the remaining 13 percent from abroad. These data are shown in Table 12.

32. The data with respect to anticipated markets clearly refute the charges made. Of a total of 621 project applications analyzed 544 indicated their probable marketing patterns. Of these, 349 showed dominant marketing patterns either in the Northeast, in the rest of Brazil or in export, while the remaining firms showed no dominant marketing pattern. (Dominant marketing pattern here was taken at 60 percent of more of total sales in one of these market categories.) Surprisingly, 297 firms anticipated that their sales would be entirely in the Northeast region, and an additional 10 firms anticipated that 60-99 percent of their sales would be concentrated there. Only 16 firms indicated a dominant sales pattern in the rest of Brazil, while 26 anticipated that the bulk of their sales would be in export. Of the 195 firms which indicated no dominant marketing pattern, some 154 indicated that their sales would be distributed in both Northeast and the rest of Brazil. Since in all these cases at least a substantial portion of sales were obviously expected to go to the Northeast, it seems a fair presumption that, combined with those firms which clearly indicated that their anticipated sales would be concentrated in the Northeast region, the great bulk of the output of the new firms approved by SUDENE would be marketed there. These data are shown in Table 13.

33. Analysis of the prospective profits anticipated by 487 approved projects show, for the entire group, an anticipated ratio of profits to sales of 25.4 percent, and a ratio of profits to total capital investment

of 32.3 percent. (The ratios of profits to non-loan capital, and to "own resources" capital, are of course considerably higher.) Of the 18 industrial branches covered, two show average prospective profits on total investment of 50 percent or more; five show anticipated rates in the 40-49 percent range; 7 show anticipated rates of 30-39 percent; and only 4 show anticipated rates under 30 percent. Of these, the lowest anticipated rate on investment is that of the chemical industries branch, with an average anticipated rate of 25.7 percent. These profits, it will be recalled, are subject at most to only half of the established 30 percent corporate income tax rate, for at least 10 years. Because most of these investments are being made by firms already established and experienced in their lines, and consequently competent to estimate costs and sales, these profit projections may be regarded as fairly realistic. It is likely, however, that difficulties in providing skilled manpower from the Center-South, and training local manpower in the Northeast, will prolong the period required for the new plants to achieve the efficiency levels implicit in their profit projections to a three to five year period, rather than to a more normal one to two years. Further, there exists as yet no adequate experience base by which these profit projections can be tested. They should therefore be regarded with some caution. This analysis is shown in Table 14.

34. The mission has adjusted projections made informally within SUDENE, which estimate the increases in gross value-added in manufacturing the projects approved through 1968 may be expected to produce. On the basis of rather conservative assumptions, they suggest an average annual growth of 9.1 percent from 1965 to 1973, compared to a rate of 7.8 percent for the period 1955-65. On the basis of somewhat more optimistic assumptions, the average annual growth rate to 1973 is indicated to be some 11.7 percent. These projections are presented in Table 15.

35. The same projections show also some interesting developments with respect to the altered structure of industrial output which may be anticipated to result from the projects approved by SUDENE thus far. These are shown, in contrast with the contributions of the various industrial branches to total value-added in 1955, 1962, 1965, in Table 16. The relative shares of the so-called traditional and the more dynamic industries (the grouping is SUDENE's) had already been changing over the years shown in favor of the latter. The projections indicate that this process will be accelerated by the SUDENE scheme, and that the structure of industry in the Northeast in consequence will be a much more diversified one than that of earlier years.

IV. Outlook and Economic Evaluation

36. Most of the material presented in the preceding section bears directly on the near-term outlook.

37. Disbursements of 34/18 funds in 1968, and the indicated ratios of 34/18 funds to total investment, suggest that manufacturing investment in the Northeast amounted to some NCr 600 or more million in that year. Committed and undisbursed deposits of 34/18 funds suggest that 1969-71 will experience additional manufacturing investment at a significantly higher level. As of the end of 1968, more than NCr 700 million of undisbursed 34/18 deposits remained in the financing pipeline. Allowing both for new resource flows additional to the present pipeline and for price erosion, we may conservatively anticipate 34/18 disbursements at about NCr 500 million yearly through 1971. The near-term outlook therefore is for manufacturing investment of about NCr 1 billion yearly, even if SUDENE's share in 34/18 deposits should level off or decline, as seems quite possible. Such outcomes could however result in an investment decline after 1971.

38. The availability of 34/18 funds, the credits prospectively available from official banks and other credit sources, and other government incentives are not the only factors which will affect significantly future investments in Northeast manufacturing industries. Other supporting factors are natural advantages in certain raw materials; somewhat lower labor costs per unit of value-added in manufacturing; disparate freight rates which afford protection against goods from outside the region and cheaper relative rates on goods exported from the region; and an improving infrastructure as regards roads, electric power, education, housing, and so on. Moreover, the current industrialization wave has put the Northeast on the investment map. Industrialists are far more aware of its existence and potentials than they were before. Many of the new projects will offer obvious expansion possibilities at lower investment to prospective income ratios than prevailed for their original investment. And external economies are rapidly being created, as industrialization grows and spreads. Finally, the combined effects of the industrialization and other major programs, and the general impetus which these impart to regional growth, employment and income, will themselves provide further impetus to industrial development. Data recently available reveal that a dramatic increase in the region's total output has taken place in recent years.1/ Output and living standards have obviously improved, and unemployment has apparently declined.2/

39. On the other side of the coin, it may be that the Northeast is rapidly approaching completion of the first major wave of its accelerated industrialization process. Projects already approved may have gone a long

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1/ Unpublished data of the Fundacao Getulio Vargas indicate that total output in the Northeast grew at average annual rates of 1.2 percent from 1949 to 1953, 5.1 percent from 1953 to 1958, and 7.5 percent from 1958 to 1965.

2/ New household surveys suggest that Northeast unemployment rates are currently far lower than had previously been thought.

way towards exploiting near-term investment opportunities and the absorptive capacities of the market. SUDENE recently reported a sharp increase to a rejection rate of some 30-40 percent on Letters of Consultation (initial informal project proposals for use of 34/18 funds). This reflects the Agency's concern that near-term investment opportunities may have been pre-empted in a number of fields and areas by projects already approved. A slowdown from current and near future investment growth rates may therefore not be far off. Such a slowdown, if it occurs, would not necessarily be undesirable, nor would it necessarily be inconsistent with the continued healthy expansion of industrialization in the Northeast.

40. The outlook for manufacturing industries will also be influenced importantly by the priorities accorded to Northeast development by the Federal Government, and by the relative emphasis given to manufacturing industries within the broader regional development priority. As regards the first of these, there is every indication that accelerated development of the Northeast region will continue for some time to be a major objective of government policy in Brazil. As regards the second, there are some indications of growing doubt as to whether the industrialization emphasis has not perhaps been overstressed, as to whether the investments realized could not have been achieved with somewhat less generous incentives, and as to whether some of the resulting investment has represented an optimum use of scarce resources. Although the great majority of industrial projects developed under the incentive scheme give strong evidence of future profitability, these doubts have some validity. Thus, progress in agriculture does not appear to have been accorded comparable or even adequate attention. Similarly, even if the tax credits and other incentives contained no element of redundancy in the earlier years of the program in relation to the investment volumes achieved, they appear to do so now.

41. Nor is it altogether clear that SUDENE's scheme of priorities for channelling resources within the industry sector is designed to allocate these resources most effectively. This system, revised as of March 1969, divides projects into five priority classes. These are permitted to use 34/18 funds up to 75 percent, 60 percent, 50 percent, 40 percent, and 30 percent of a project's total non-loan financing, respectively, depending on the number of points awarded them by SUDENE on the basis of stated criteria. A point count of 50 or more presumably entitles a project to a 75 percent use of 34/18 funds, while the lesser categories are awarded for point counts of 40-49, 30-39, 25-29, and less than 25 points, respectively. The criteria employed are plant location, essentiality, use of regional inputs, import substitution, dispersed ownership, labor absorption and labor participation in profits.

42. The points awarded for location range from a maximum of 25 down to 10. The highest points are accorded to the least developed states within the region. Recife and Salvador, which received a heavy concentration of approved projects till now, are not entitled to any points under the location criterion in the new point award system as revised in March, 1969. Clearly, this criterion is designed to spread the benefits of industrialization to the maximum feasible extent throughout the Northeast. Equally clearly it is dubious whether SUDENE should give high rewards for such a distribution.

Incentives to bring manufacturing industry to a region as large as the Northeast may be justified, but the indefinite extension of this principle within the region must sooner or later run counter to natural and economic location advantages. The current point awards appear to have gone somewhat beyond the boundaries of a logical priorities scheme, even though it is doubtful that this award would be sufficient to distort a location decision in other than marginal cases.

43. The essentiality criterion awards a maximum of 20 points to industries which produce goods considered essential to regional development within the following categories:

- capital goods and basic intermediate goods, 20 points;
- other intermediate goods, 15 points;
- consumer durables and textiles, 10 points.

Which industries within these categories will be considered essential is obviously left to SUDENE's judgment, but the criterion obviously aims at developing a more modern, balanced and relatively autonomous regional industry structure. Here again the rationale appears to be rather dubious, in that it runs counter to specialization and comparative advantage. Capital and intermediate goods might or might not contribute more in any given case to the region's economic development than might consumer durables, textiles or any other consumer goods industry, and it is doubtful whether relative essentiality should be measured on this basis.

44. The third criterion awards 15 points to a project if 80 percent or more of its material inputs originate in the Northeast, and 10 points if 50-79 percent of its materials so originate. This criterion appears to be a reasonable one.

45. The award, however, of 10 points to projects which are import substituting from the point of view of the national economy does not appear to be justifiable. Import substitution in Brazil manufacturing has been vigorously promoted for at least 15 years and industry nationally is in general highly protected. There would seem to be little justification for further inducements to national import substitution, and even less justification for such priorities within a regional development effort. On the other hand, the award of 10 points to projects which will export at least 40 percent of their sales outside the country is certainly justified. Indeed, it might make sense to increase the point maximum for projects which would export even larger proportions of their product.

46. The labor absorption criterion has two components. One awards five points to projects in which labor costs and social charges connected with them represent over 25 percent of gross value added (the average for all approved projects). In view of the need to create jobs in the Northeast, and to influence the relative use of the productive factors so as to maximize the use of plentiful labor and conserve the use of scarce capital (in this case, to counteract partially the free capital aspect of the 34/18 system), the points awarded in such cases, it would appear, should be substantially increased.

47. The second component of the labor absorption criterion is a formula, the effect of which is to award points proportional to the amount of employment created, up to a maximum of 25 points for projects which employ 1,000 or more workers. There would seem to be a prima facie case for this.

48. The remaining criteria, each of which bears a rating of five points, do not require comment here.

49. In evaluating the point values built into the overall priority scheme, it should be kept in mind that SUDENE retains a certain degree of flexibility so that it is not rigidly bound to adhere to this scheme. At the same time it is difficult not to conclude both that the values built into the system are somewhat distorted, and that certain elements which should be incorporated into a priority scheme are lacking. Among these, it is suggested, should be criteria which would accord priorities to projects outstanding with respect to their technical and economic feasibility; projects which promised to be viable, within a few years, at only moderate levels of customs protection; projects in which a substantial share of the total financing required would be contributed in the form of "own resources" (this would mean, for projects to which a high percentage of 34/18 approval was granted, relatively little or no use of borrowed funds); projects in which "own resources" investment was made by regional producers; and projects committed to significant manpower training programs. The foregoing comments on SUDENE's priority system should not be construed to mean that the system is not working at least reasonably well. Since very few of even the small proportion of projects already completed have had a full run-in period, there does not as yet exist an adequate empirical basis for such a judgment. What does seem likely is that the priority system can be strengthened and improved, and that a careful consideration of these possibilities would prove to be rewarding.

50. It may be of interest to recapitulate briefly the findings of this study, insofar as they suggest the balance of payments implications of the industrialization program. It has been indicated that near-term investment in manufacturing industries should approximate NCr 1 billion yearly for the period 1969-71. Of this, experience thus far indicates that the external financing component will amount to some 20 percent -- 15 percent loan financing, and 5 percent equity financing. The foreign import component of this investment may be expected to correspond roughly to this financial contribution. Since previous analysis of the program has also indicated a sales/investment ratio of approximately 5:4, a raw materials to sales ratio of 4:10, and a materials import component of 13 percent from abroad, it may crudely be estimated that the three year increment in annual materials imports by 1971 may be some NCr 190-200 million (1968 prices). It is more difficult to approximate exports, since the geographic market analysis is based on the number of projects, rather than on their projected sales values, and since many firms did not indicate a dominant market pattern. A crude estimate, thus qualified, is that near-term exports may amount to some 5-6 percent of projected sales, or a three-year increment of some NCr 190-225 million (1968 prices) by 1971.

51. If one appraises the industrialization incentive program in the Northeast by the degree of success it has achieved in mobilizing and transferring resources to the Northeast and in committing these resources to investment in manufacturing industry, there is no doubt that this program has been highly successful. If one applies the further major test of the prospective profitability of the projects thus induced, the analysis presented in paragraph 33 suggests that by this test too the program will, in all likelihood, prove to be successful. It appears also that a reasonable proportion of raw material inputs required by these projects will originate in the Northeast, and that by far the greater part of the goods produced will be marketed within the region. Fears that the program will generate a great deal of unnecessary transportation to and from the Northeast would appear therefore to be unwarranted. The structure of the Northeast's manufacturing industries is becoming more diversified, and external economies are undoubtedly developing. While direct employment gains will be modest relative to needs, the indirect employment effects should be more substantial. Investment per worker does not appear to be excessive relative to that which prevails in the rest of Brazil.

52. On the other hand, as already stated, it appears that the incentives which have been made available to investors in the Northeast are excessive in relation to the volume of investment evoked. The 50 percent tax credit is very sizeable, both in the individual benefits it confers and in relation to the Federal budget deficit. The maximum grant of 75 percent of total project investment which is possible within the present system appears to be larger than is necessary, equitable or desirable. The very nature of the incentive system opens it to certain abuses. The priority criteria employed by SUDENE are not as well adapted to prevailing circumstances and needs as they ought to be, and the combination of system and circumstance is resulting in an increasingly dominant role in Northeast manufacturing by Center/South investors. Many Northeast firms with legitimate claims to modernization and expansion of their enterprises are finding it difficult to obtain 34/18 financing for their projects. They are unwilling to pay the high commissions and/or equity participating brokers are reportedly charging for assistance in arranging for them.[1] Investment in the Northeast, to be sure, is desirable on many counts, no matter where it originates. However, 100 percent ownership and control of Northeast enterprises by firms outside the Northeast does mean that a sizeable portion of the proceeds from these enterprises will flow outside the region, which in the case of regional ownership would tend to be re-invested or spent within the region. Taking the regional development emphasis as given, the implications of this for further development of the Northeast are not as beneficial as would be the case, other things being equal, under Northeast ownership.

1/ Many however are too small to be able to prepare the elaborate and costly project proposals required by SUDENE. These must rely on the separate small and medium-size industry program in which BNB moneys are re-lent through state development banks, and on state technical assistance programs.

53. Another point merits consideration in an economic evaluation of this program. The growth of manufacturing in Brazil in recent years, it has already been suggested, was stimulated and supported chiefly by protectionism and its companion policy of import substitution. For the Brazilian economy as a whole, import substitution has pretty well run its course. Since these policies have resulted in a relatively high cost industry, export potentials for the near-term are not great in absolute terms, and continued vigorous growth for some time to come must depend on a combination of greater productive efficiency and expansion of the internal market. In this sense, the incentive program to industrialize the Northeast reduces, though probably only in minor degree, the near-term prospects of the manufacturing industries in Sao Paulo, Guanabara, and other industrial centers for achieving the larger production units and economies of scale essential to a solution of the general Brazilian development problem. Although it is sensitive to this consideration, the mission is not disposed to question the basic regional development policy objective. Neither is it inclined to question the need for continuation of the industrialization incentive scheme. It does conclude, however, that the time has come to moderate somewhat, along the lines already indicated, the incentives offered and the criteria employed.

54. There has been little public discussion thus far of what the industrialization incentive program's specific goals should be, how long the program should last, or what the criteria for transitional arrangements and ultimate termination should be. In the prevailing climate, these questions are delicate. People in the Federal Government, and Center/South industrialists, seem hesitant to offend Northeast sensibilities. In the Northeast, officials and industrialists hesitate to discuss infirmities in the system, even though they may view these objectively, for fear any opening up of the issues will result in substantial curtailments in existing incentives. Further, no one seems to have taken adequately into account the near-term implications of the huge volume of approved projects already in the pipeline, in relation to what investment volumes and incentives are still necessary and desirable, and the possible timing of orderly change.

55. In conclusion, the industrialization program for the Northeast may be considered to constitute an imaginative and, on balance, constructive approach to one of Brazil's major problems. In channelling sizeable amounts of public resources into productive private investments in the region, it contributes to reducing the traditional disparity in incomes between the Northeast and the rest of Brazil. Despite the substantial contributions it has already made, and its further contributions which will derive from approved projects not yet completed, continuation of the program is clearly in order for some time to come. However, its very successes reduce the degree of incentives required for its successful continuation. This, together with other considerations already presented, suggests that the program could be strengthened and improved if the following steps were taken:

a) the 50 percent tax credit were reduced to 35-40 percent, with the difference of 10-15 percent going to SUDENE-BNB for grants and loans to Northeast-sponsored enterprises, in order to facilitate the flow of 34/18 resources to Northeast-sponsored projects which have had difficulty in obtaining them;

b) the share of 34/18 funds permitted to a project were reduced from a maximum of 75 percent to a maximum of 50 percent;

c) the minimum "own resources" investment in 34/18 projects were increased from the present 12½ percent to something between 18.75 to 25 percent. either by giving effect to b) immediately above, or by limiting BNB loans to such projects to the extent necessary to ensure such a result;

d) SUDENE's point criteria system were modified along the lines already suggested; and

e) BNB's lending were at positive interest rates.

Appendix I

SUDENE's 34/18 Regulations

A description of SUDENE's 34/18 regulations is presented in this appendix.

1. The term 34/18 originates from Article 34 of Law 3995 (Dec. 14, 1961) and Article 18 of Law 4239 (June 27, 1963). These govern the creation of the tax credit investment funds. Law 4869, of December 1, 1965 (supplemented by still others and referred to here as the "old system"), and Law 5508 of October 11, 1968 (supplemented by Decree 64.214 of March 18, 1969, referred to here as the "new system"), regulate the use of these funds. The older system, in effect until March, 1969, is summarized below. Recent changes (the new system) are explicitly indicated.

2. Source and uses of 34/18 funds - Corporations throughout Brazil may discount up to 50 percent of their corporate tax liability for investment in new or existing agricultural, industrial and telecommunications projects in the area under SUDENE's jurisdiction, which SUDENE has declared or may declare to be of interest to the development of the Northeast.

3. The depositor - Corporate taxpayers may deposit such amounts in a special account (conta bloqueada) with the BNB or with the Bank of Brazil or Caixa Economica Federal,when the BNB has no local branch, (or tranfer to the BNB). The depositor will register such deposits with the income tax authorities. These deposits bear no interest.

4. The timing - Until recently, the depositor was required to choose the project in which he wished to invest and notify SUDENE in writing, within the end of the third year following the year in which the tax was due, and await SUDENE approval. In the new system, the depositor may choose freely up to the end of the first year, or invest in projects indicated by SUDENE up to the end of the second year following that in which the tax was due. For deposits made in 1966 and 1967, however, the time limit is December 31, 1969. If these time limits are not observed, the funds will be transferred to a fund for application in the Northeast area by SUDENE.

5. Permissible Projects - 34/18 funds may be invested in agricultural, industrial, and telecommunications projects in the Northeast (including the states of Maranhao, the Island of Fernando de Noronha, and that part of Minas Gerais state which lies within the drought polygon) which have been approved by SUDENE. Article 5 of the 1969 decree includes under "industrial or agricultural enterprises":

- i. Agriculture, cattle raising and other related activities;
- ii. Forestry and fisheries;
- iii. Mineral extraction;
- iv. Manufacturing industries, classified in twenty branches;
- v. Other activities, if SUDENE recognizes them as industrial or agricultural.

The new system also allows investment in electric power generation, transmission and distribution projects.

6. Application for approval - Entrepreneurs interested in launching a project in the Northeast will initially address to SUDENE a "consultation letter," on which SUDENE should take final action within 150 days of receipt. Acceptance of the project outline contained in the "consultation letter" by SUDENE should precede submittal of a formal project application.

7. The form of 34/18 participation - Of the total of 34/18 funds incorporated into a project as shares, at least 50 percent of the shares must be preferential and with no voting rights (the 50 percent may be set relative to all 34/18 shares, or relative to the holdings of each depositor). This is designed to protect the entrepreneurs who organize and provide the "own resource" equity financing from 34/18 depositors-investors who would otherwise control the company.

8. In the new system, all 34/18 depositor shares must be nominal and cannot be transferred up to five years after the project has started to "function normally" as determined by SUDENE (the old decree is not specific on the issue of share transferability).

9. If 34/18 funds are committed as loans to a project, these loans may not be called within five years of the completion of the project. In the new system, the loans:

a) are not transferable within five years after the project has reached "normal functioning" as defined by SUDENE;

b) will receive interest of not over 12 percent p.a.;

c) will receive no monetary correction;

d) will be amortized, after five years, in installments of 20 percent p.a..

10. Participation of 34/18 deposits in total investment - The 34/18 funds in a project, whether as share capital or as loans, may not exceed 75 percent of the "difference between the financial coverage of the total investment (including working capital) and the financing conceded to the investment by other sources of credit" (including presumably all loans, official or private, domestic or foreign, excepting only 34/18 deposit commitments made under the forms of loans). This is reinforced by the statement that "own resources may never be less than one-third of the 34/18 funds in any one project." This is maintained in the new system, with one exception. In firms which are characterized by foreign control, 34/18 funds may not exceed the value of own resources. Own resources may consist of: (a) cash; (b) undistributed profits; (c) shareholders' credits; (d) fixed investments already existing in the Northeast, registered on the books since December 19, 1968, at historical cost; (e) used capital equipment, brought from outside the Northeast and valued at historical cost. These, however, as appraised by SUDENE, must be used

in pioneering projects or in the expansion of projects which have already been functioning for three years; must not be technologically inferior to equipments used in other parts of the country; must be less than five years old; and must not exceed 30 percent in value of total fixed investments. If the equipment is foreign, it will only be admitted if no "similar" exists.

11. In the new system, "own resources" may consist of items (a), (b), and (c) above; and item (d), provided the equipment has been on the books for less than five years by the time of the application; or is new capital equipment. The provision for incorporating used capital equipment brought from outside the Northeast is missing in the new system.

12. Priority criteria - The old system divided projects into three categories, allowing for a participation of 34/18 funds in the amount of 25 percent, 50 percent or 75 percent of total non-loan financing. While these categories are determined by the number of points accorded each project on the basis of stated criteria, SUDENE has retained flexibility in this respect. Until March, 1969, SUDENE reserved the right to add up to 10 points or subtract up to 15 points from a project's point count "upon consideration of other aspects of essentiality in the project and the availability of 34/18 funds." Since a total of 50 or more points are required to qualify for the maximum 34/18 participation of 75 percent, this 10-15 percent flexibility range was quite significant. In the new system, this flexibility is maintained. Furthermore, SUDENE may now bypass the point system altogether in deciding on the amount of 34/18 participation "whenever it considers a project to be of high priority for the region's development within the directions of the 'Plano Diretor.'"

13. Other issues - The following are mentioned only in the new decree, which is more detailed (and twice the length) of the old law.

a) Foreign remittances - profits derived from the investment of 34/18 funds may under no circumstances be remitted outside the country, under severe penalties. This does not affect the remittance of profits which correspond to direct foreign investment, duly registered and under the conditions set forth by present legislation. This also does not prohibit the utilization of profits derived from 34/18 funds to purchase foreign equipment which do not have a domestic "similar."

b) Reinvestments - SUDENE area firms may, for reinvestment purposes, deposit in the BNB 50 percent of their corporate income tax liability, with the addition of half of this amount in own resources. These funds can be freed for reinvestment only by SUDENE. SUDENE's verification and approval procedures will however be less demanding in such cases.

c) BNB financing or guarantee - projects requiring BNB financing or guarantee will be submitted simultaneously to SUDENE and BNB. BNB may not approve any such projects previous to SUDENE's favorable recommendation, and has 60 days in which to decide on the project after SUDENE's recommendation. Should BNB reject the financing application, it must explain the reasons in writing to SUDENE. This communication will remain confidential.

Table 1 : STRUCTURE OF INDUSTRY - NORTHEAST AND BRAZIL - 1958

Gross Value Added in Each Branch

As Per Cent of Gross Value Added[1/] in Manufacturing Industry

	Northeast	Brazil
Traditional	73.7	44.8
Food and Beverages	38.2	17.2
Textile and Clothing	31.1	17.5
Tobacco	1.9	1.5
Printing	1.2	3.2
Wood Products and Furniture	1.3	5.4
Other	26.3	55.2
Non-metallic Mineral Products	3.2	6.5
Metal	1.9	12.2
Mechanical Equipment	.2	3.0
Electrical Equipment	.0[2/]	4.4
Transportation Equipment	.2	7.0
Paper	1.4	2.8
Rubber	.2	1.8
Leather	1.7	1.2
Chemicals[3/]	17.3	13.7
Sundries	.2	2.6
Total Manufacturing	100.0	100.0

Source: IBGE, *Producão Industrial Brasileira, 1958*

1/ Value added was computed for firms with 5 or more workers.

2/ Less than .05%.

3/ Includes also cosmetics, pharmaceutical products and plastics.

Table 2 : VALUE OF OUTPUT, GROSS VALUE ADDED AND EMPLOYMENT IN MANUFACTURING INDUSTRY 1/

NORTHEAST AND BRAZIL - 1949, 1958, AND 1966

	VALUE OF OUTPUT			GROSS VALUE ADDED			EMPLOYMENT		
	NCr$ Million (1968 Prices)		Per Cent	NCr$ Million (1968 Prices)		Per Cent	1,000 Workers		Per Cent
	Northeast	Brazil	Northeast/ Brazil	Northeast	Brazil	Northeast/ Brazil	Northeast	Brazil	Northeast/ Brazil
1949	1,712.1	17,034.5	10.1	801.5	7,527.9	10.6	214	1,283	16.7
1958	2,293.3	33,236.3	6.9	948.9	14,583.1	6.5	189	1,719	11.0
1966	3,717.7	54,283.0	6.8	1,717.1	27,469.8	6.3	209	2,139	9.8
				ANNUAL GROWTH RATES - PERCENT					
1949 - 1958	3.3	7.7		1.9	7.6		-1.4	3.3	
1958 - 1966	6.2	6.3		7.7	8.3		1.3	2.8	

Sources : IBGE, Censo Industrial 1950; IBGE, Producão Industrial Brasileira 1958, and Mission Data

1/ Firms of all sizes.

NOTE: Recent household surveys suggest that the data shown here exclude by definition many self-employed household workers, and that such exclusions are proportionately greater in the Northeast than in Brazil as a whole. (See IBGE/IBE/DEPD, Pesquisa Nacional por Amostra de Domicilios.)

Table 3: FISCAL INCENTIVES (Deposits)

1962-1968

Year	Current NCr$1,000						NCr$1,000 (1968 Prices)	Percentage of Yearly Totals	
	Sudene (34/18)	Sudam	Embratur (Tourism)	Sudepe (Fishing)	Reflorestamento (Reforestation)	Total	Total	Sudene	Sudam
1962	5,700	-	-	-	-	5,700	65,500	100.0	
1963	7,700	1,078	-	-	-	8,778	58,110	87.8	12.2
1964	37,300	3,316	-	-	-	40,616	140,896	91.8	8.1
1965	149,400	13,047	-	-	-	162,447	358,683	91.9	8.1
1966	226,600	46,807	-	-	-	273,407	436,084	82.9	17.1
1967	351,100	101,858	1/	1/	1/	452,958	561,667	77.6	22.4
1968	457,870	163,101	35,771	42,736	11,306	710,784	710,784	64.5	22.9
Total	1,235,670	329,207	35,771	42,736	11,306	1,654,690	2,331,724	78.5 2/	17.6 2/

1/ **Data not available, but are presumed to have been negligible.**

2/ **In constant prices.**

Source: Ministry of Finance and Fundacao Getulio Vargas.

Table 4: 34/18 DEPOSITS - COMPARISON WITH TAX PAYMENTS OF FIRMS, THE FEDERAL GOVERNMENT BUDGETARY REVENUES AND ITS CASH DEFICIT

Year	Tax Payments of Firms 1/	Federal Government Budgetary Revenues	Federal Government Cash Deficit	34/18 Deposits			
	Million NCr$ Current			Million NCr$ Current	As per cent of Tax Payments of Firms	As per cent of Federal Government Budgetary Revenues	As per cent of Federal Government Cash Deficit
1962	58	564.9	280.9	5.7	9.8	1.0	2.0
1963	122	1,051.7	504.2	7.7	6.3	0.7	1.5
1964	195	2,240.1	700.0	37.3	19.1	1.7	5.3
1965	405	3,912.3	587.9	149.4	36.9	3.8	25.4
1966	507	5,913.2	586.6	226.6	44.7	3.8	38.6
1967	633	6,814.1	1,224.7	351.1	55.4	5.2	28.7
1968	901	10,275.4	1,226.7	457.9	50.8	4.5	37.3

1/ Net of tax credits.

Sources: Income Tax Division (Ministry of Finance); Ministry of Planning, 1970 Federal Budget Proposal; and SUDENE.

Table 5: 34/18 DEPOSITS, APPROVALS, AND DISBURSEMENTS

1962 - 1968

(Million NCr$ in current prices)

Year	Deposits	Approvals[1/]	Disbursements[2/]
1962	7	-	-
1963	8	7	-
1964	36	26	3
1965	149	33	8
1966	227	152	39
1967	351	496	157
1968	458	507	316
TOTAL	1236	1221	525

1/ 34/18 share in industrial projects only.

2/ Including NCr$ 35 million for agricultural projects and NCr$ 33 million for working capital applications.

Source: SUDENE

Table 5A : 34/18 FUNDS DISBURSED ON APPROVED SUDENE PROJECTS

Year	(NCr$1,000 Current Prices) Industrial and Telecommunications Projects	Agricultural Projects	Applications for Working Capital	Total	NCr$1,000 1968 Prices Total
1963	92.4	-	-	92.4	611.7
1964	3,366.1	-	-	3,366.1	11,677.0
1965	8,050.8	-	-	8,050.8	17,776.6
1966	36,626.8	766.0	1,623.9	39,016.7	62,231.6
1967	124,024.9	10,735.9	22,288.2	157,049.0	194,740.8
1968	283,459.2	23,592.3	8,756.5	315,807.9	315,807.9
1969 (Jan.1 - Mar. 20)	n. a.	n. a.	n. a.	79,885.8	71,595.0

Source: SUDENE

Table 6: DISTRIBUTION OF SUDENE APPROVED PROJECTS, 1960-1968, BY SIZE CATEGORY

NUMBER AND TOTAL INVESTMENT OF PROJECTS IN EACH CATEGORY

Year of Approval	Size Categories of Approved Total Investment (In NCr$ million, March 1968, Prices)							
	to-.9	1.0-1.9	2.0-4.9	5.0-9.9	10.0-19.9	20.0-49.9	Over 50.0	Total All Sizes
				Number of Projects in Each Category				
1960	1	7	5	3	3	3	-	22
1961	4	4	3	2	3	2	1	19
1962	12	7	12	10	7	3	-	51
1963	36	4	9	3	3	4	-	59
1964	31	6	7	3	4	1	1	53
1965	32	9	9	4	5	-	-	59
1966	37	14	10	6	5	3	-	75
1967	61	27	31	12	11	7	3	152
1968	34	30	37	23	14	5	-	143
Total	248	108	123	66	55	28	5	633 1/
				Total Investment of Projects in Each Category (NCr$1,000 at 1968 Prices)				
1960	173	9,568	18,649	16,732	41,535	80,018	-	166,676
1961	2,300	6,007	7,441	11,550	43,409	72,585	200,023	343,315
1962	3,825	9,554	39,833	70,626	106,902	74,757	-	305,499
1963	12,066	5,770	26,789	21,123	48,372	113,173	-	227,293
1964	7,009	8,606	19,874	17,687	51,531	26,896	234,474	366,077
1965	12,436	10,571	31,535	26,372	79,966	-	-	160,881
1966	13,783	18,567	36,970	42,602	71,764	96,880	-	280,566
1967	30,755	38,149	98,988	84,910	155,107	191,307	253,575	849,790
1968	19,361	42,222	121,516	170,780	208,017	170,730	-	732,626
Total	101,709	149,014	398,595	462,382	806,604	826,347	688,072	3,432,721

1/ A few projects were not included, as data on the investment total were not yet available.

Source: SUDENE.

Table 7: DISTRIBUTION OF SUDENE PROJECTS BY STATE AND BY INDUSTRY GROUP

1960-1968

NUMBER OF PROJECTS

	PERNAMBUCO	BAHIA	CEARÁ	ALL OTHER NORTHEAST	TOTAL NORTHEAST	EACH INDUSTRY BRANCH AS PER CENT OF TOTAL
Consumer Goods	69	41	59	89	258	41.9
Textiles	27	17	18	41	103	16.8
Clothing and Footwear	8	4	12	7	31	5.0
Food	21	14	24	36	95	15.5
Beverages	5	4	1	-	10	1.6
Tobacco	-	1	-	1	2	0.3
Printing and Publishing	4	-	-	1	5	0.8
Furniture and Fixtures	4	1	4	3	12	1.9
Intermediate Goods	103	72	39	75	289	46.9
Non-metallic Minerals Mfgs.	24	19	9	18	70	11.4
Metal Industries	22	12	9	14	57	9.3
Wood and Wood Products	2	9	2	4	17	2.8
Paper and Paper Products	11	3	5	6	25	4.1
Rubber	4	3	-	-	7	1.1
Leather and Leather Products	5	1	2	3	11	1.8
Chemicals 1/	35	25	12	30	102	16.4
Capital Goods	26	16	4	11	57	9.3
Mechanical	5	4	-	3	12	1.9
Electrical	17	6	4	2	29	4.8
Transport Equipment	4	6	-	6	16	2.6
Others	7	-	1	4	12	1.9
TOTAL	205	129	103	179	616	100.0
Percent of Northeast	33.3	20.9	16.7	29.1	100.0	

1/ Including also Cosmetics, Pharmaceuticals, and Plastics.

Source: SUDENE

Note: Due to incomplete data, a few projects were not listed.

Table: 8: DISTRIBUTION OF INVESTMENTS BY STATE AND BY INDUSTRY GROUP

SUDENE APPROVED INDUSTRIAL PROJECTS

1960 - 1968

(NCr$ 1,000 at March 1968 Prices)

	PERNAMBUCO	BAHIA	CEARA'	ALL OTHER NORTHEAST	TOTAL NORTHEAST	EACH INDUSTRY BRANCH AS PER CENT OF TOTAL	STATES AS PER CENT OF TOTAL NORTHEAST: Pernambuco, Bahia, and Ceara'	STATES AS PER CENT OF TOTAL NORTHEAST: All Other States
CONSUMER GOODS	335,917	190,411	208,687	241,810	976,825	30	75	25
Textiles	170,681	94,546	130,451	159,727	555,405	17	71	29
Clothing and Footwear	17,381	5,363	27,120	9,685	59,549	2	84	16
Food	66,153	55,219	34,835	64,082	220,289	7	71	29
Beverages	76,531	32,772	11,481	-	120,784	4	100	-
Tobacco	-	2,147	-	1,130	3,277	-	66	34
Printing and Publishing	3,189	-	-	2,060	5,249	-	61	39
Furniture and Fixtures	1,982	364	4,800	5,126	12,272	-	58	42
INTERMEDIATE GOODS	714,481	860,203	91,196	340,768	2,006,648	60	83	17
Non-metallic Mineral Mfgs.	108,075	136,490	37,449	97,378	379,392	11	74	26
Metal Industries	104,849	338,982	19,741	23,672	487,244	15	95	5
Wood and Wood Products	19,052	34,575	3,786	5,004	62,417	2	92	8
Paper and Paper Products	78,043	8,161	3,988	57,451	147,643	4	61	39
Rubber	13,453	960	-	-	14,431	-	100	-
Leather and Leather Products	7,423	3,226	9,600	5,685	25,934	1	78	22
Chemicals 1/	383,586	337,809	16,632	151,578	889,605	27	83	17
CAPITAL GOODS	160,404	94,057	10,775	44,074	309,310	9	86	14
Mechanical	30,091	23,877	-	26,925	80,893	2	67	33
Electrical	83,975	36,520	10,775	4,402	135,672	4	97	3
Transport Equipment	46,338	33,660	-	12,747	92,745	3	86	14
OTHERS	14,343	-	2,685	6,845	23,873	1	71	29
TOTAL	1,225,146	1,144,671	313,342	633,497	3,316,656	100	81	19

1/ Including also Cosmetics, Pharmaceuticals, and Plastics

Source: SUDENE

Note: Due to incomplete data, a few projects were not included.

Table 9: ANTICIPATED JOB CREATION ASSOCIATED WITH SUDENE PROJECT APPROVALS, AND ANTICIPATED INVESTMENT PER MAN EMPLOYED

1960 - 1968

	Anticipated Jobs	Investment Per Worker NCr$ at 1968 Prices
Consumer Goods	63,331	15,064
Textiles	35,217	14,450
Clothing and Footwear	6,922	9,153
Food	13,714	14,802
Beverages	3,089	41,403
Tobacco	910	2,512
Printing and Publishing	218	24,750
Furniture and Fixtures	1,261	10,365
Intermediate Goods	38,759	54,259
Non-metallic Mineral Mfgs.	9,431	42,764
Metal Industries	8,839	58,557
Wood and Wood Products	2,482	26,763
Paper and Paper Products	3,970	39,567
Rubber	1,033	14,248
Leather and Leather Products	1,125	24,551
Chemicals	11,879	77,138
Capital Goods	10,935	30,076
Mechanical	2,317	37,182
Electrical	5,901	24,485
Transport Equipment	2,717	36,158
Other	1,148	22,147
TOTAL	112,173	30,133

Source: SUDENE

Table 10: OPERATIONAL AND CONSTRUCTION STATUS OF INDUSTRIAL PROJECTS APPROVED BY SUDENE (as of December 31, 1968)

NUMBER OF PROJECTS

States	New Projects			Modernization			Sub-totals		Grand Total
	Functioning	In Construction	In Project Phase	Functioning	Being Installed	Programmed	New Projects	Modernization	
Maranhao	1	-	5	1	2	5	6	8	14
Piaui	5	1	1	-	3	-	7	3	10
Ceara	32	18	20	8	7	20	70	35	105
Rio Grande do Norte	7	7	7	2	1	9	21	12	33
Paraiba	19	19	13	2	6	18	51	26	77
Pernambuco	44	54	37	15	22	41	135	78	213
Alagoas	10	7	5	1	1	5	22	7	29
Sergipe	2	1	2	-	3	5	5	8	13
Bahia	34	39	22	3	10	32	95	45	140
Minas Gerais	1	5	4	-	-	1	10	1	11
Northeast	155	151	116	32	55	136	422	223	645

Source: SUDENE

Table 11: PROGRAMMED COMPOSITION OF FINANCING OF SUDENE-APPROVED INDUSTRIAL PROJECTS

CURRENT NCr$ 1,000 AND PER CENT OF TOTAL INVESTMENT

Years	Number of Projects Approved	Total Projected Investment	Firms' Own Resources	Percent	34/18 Funds	Per Cent	Official Bank Loans 1/	Per Cent	Foreign 2/ Financing	Per Cent
1960	22	7,519	7,519	100.0	-	-	-	-	-	-
1961	19	10,095	10,095	100.0	-	-	-	-	-	-
1962	51	15,382	10,016	65.1	-	-	1,912	12.4	3,454	22.5
1963	57	36,393	13,600	37.4	7,309	20.1	11,742	32.3	3,742	10.4
1964	52	133,391	45,203	33.9	26,364	19.8	7,755	5.9	54,068	40.5
1965	59	138,971	67,833	48.8	33,052	23.8	33,310	24.0	4,776	3.4
1966	81	335,419	79,922	23.9	152,439	45.5	75,881	22.6	27,177	8.1
1967	155	1,099,690	230,920	21.0	495,960	45.2	186,872	16.9	186,838	16.9
1968	149	1,107,716	228,406	20.6	507,125	45.8	163,529	14.8	208,656 3/	18.8

1/ BNB, BNDE and Banco do Brasil. Loan amounts proposed in the project application. The official banks may subsequently approve a smaller amount. Total BNB and BNDE loans approved on SUDENE projects between 1965 and 1968, as registered by the banks themselves, total approximately NCr$ 350 million.

2/ Represents proposed utilization of foreign loans, at the time of the project approval by Sudene, i.e. prior to any bank commitment.

3/ IDB loans only. Data not available on other foreign loans, but they are assumed to be negligible.

Source: SUDENE. 1968 figures calculated by Mission from raw data supplied by SUDENE.

Table 12: PROJECTED SOURCE OF MATERIAL INPUTS, BY AREA 1/

487 INDUSTRIAL PROJECTS APPROVED BY SUDENE,

1960-1968

Industry Branch	Number of Projects	Cost of Material Inputs 2/ Total (current NCr$ million)	Per Cent of Total Material Input Cost: From Northeast	From Rest of Brazil	From Abroad
Consumer Goods	164	369.1	65.6	31.6	2.8
Textiles	39	116.4	81.6	16.0	2.4
Clothing and Footwear	30	90.1	15.8	84.2	-
Food	72	127.3	90.3	9.6	0.1
Beverages	6	18.6	44.0	19.9	36.1
Tobacco	2	2.9	100.0	-	-
Printing and Publishing	5	6.1	43.3	56.6	0.1
Furniture and Fixtures	10	7.7	58.1	41.9	-
Intermediate Goods	252	423.1	47.9	31.1	21.0
Non-metallic Mineral Mfgs.	70	77.2	80.0	9.7	10.3
Metal Industries	55	125.4	19.3	58.7	22.0
Wood and Wood Products	16	11.6	85.4	14.6	-
Paper and Paper Products	24	30.9	71.1	23.9	5.0
Rubber	4	5.1	25.9	71.9	2.2
Leather and Leather Products	11	13.4	96.1	3.9	-
Chemicals 3/	72	159.5	44.4	23.1	32.5
Capital Goods	55	198.5	6.9	80.9	12.2
Mechanical	11	15.0	2.5	96.5	1.0
Electrical	28	80.7	15.5	55.2	29.3
Transport Equipment	16	102.8	0.9	98.6	0.5
Others	15	17.6	25.7	24.4	49.9
Total	486 4/	1,008.3	45.9	40.9	13.2

1/ As presented in project applications.

2/ "Material inputs" include main and secondary raw materials and packaging materials; do not include fuel and lubricants.

3/ Includes also cosmetics, pharmaceuticals, and plastics.

4/ One of the 487 projects did not present the material cost breakdown by Source.

Source: Prepared by the Mission from raw data supplied by SUDENE.

Table 13: PROJECTED DISTRIBUTION OF SALES BY AREA

349 SUDENE - APPROVED INDUSTRIAL PROJECTS WITH DOMINANT MARKET PATTERN 1/

1960-1968

NUMBER OF FIRMS

	To Northeast		To Rest of Brazil		Exports Abroad		Number of Projects
	100% Of Sales	60-99% Of Sales	100% Of Sales	60-99% Of Sales	100% Of Sales	60-99% Of Sales	With Dominant Pattern
Consumer goods	94	5	2	8	14	2	125
Intermediate goods	178	5	3	2	5	5	198
Capital goods	25	-	1	-	-	-	26
Total	297	10	6	10	7	7	349

AS PER CENT OF ALL FIRMS WITHIN EACH CATEGORY

	To Northeast 100% Of Sales	To Northeast 60-99% Of Sales	To Rest of Brazil 100% Of Sales	To Rest of Brazil 60-99% Of Sales	Exports Abroad 100% Of Sales	Exports Abroad 60-99% Of Sales	Number of Projects With Dominant Pattern
Consumer goods	75	4	2	6	11	2	100
Intermediate goods	88	3	2	1	3	3	100
Capital goods	96	-	4	-	-	-	100
Total	85	3	2	3	5	2	100

1/ As presented in the project applications. Of 619 applicants, 75 did not indicate a marketing pattern; 195 indicated the areas in which they planned to sell, without showing a dominant pattern; the remainder indicated that 60% or more of sales would be to a given area, as shown above.

Source: Prepared by the Mission from raw data supplied by SUDENE.

Table 14 : PROJECTED INVESTMENT, SALES AND PROFITS OF 487 SUDENE-APPROVED INDUSTRIAL PROJECTS 1/

Industry Branch	Number of Projects	(in current NCr$ million) Investment Total	Sales Total	Profits Total	Investment per Project	Ratios (Per Cent) Sales/ Investment	Profit/ Sales	Profits/ Investment
Consumer Goods	165	538.1	823.1	194.2	3.4	152.1	23.6	36.1
Textiles	39	267.9	265.1	78.2	6.9	99.0	29.5	29.2
Clothing and Footwear	31	66.1	171.3	35.3	2.1	259.0	20.6	53.4
Food	72	114.6	256.6	47.0	1.6	224.0	18.3	41.0
Beverages	6	56.6	75.0	19.8	9.4	132.0	26.4	34.9
Tobacco	2	3.8	7.4	2.0	1.9	196.0	27.5	53.9
Printing and Publishing	5	17.3	22.6	6.2	3.5	130.0	27.4	35.8
Furniture and Fixtures	10	11.8	25.1	5.7	1.2	213.0	22.6	48.1
Intermediate Goods	252	1,154.0	1,205.2	344.2	4.6	104.4	28.5	29.8
Non-metallic Mineral Mfgs.	70	354.3	305.2	97.9	5.1	86.0	32.1	27.6
Metal Industries	55	181.9	247.5	58.6	3.3	137.0	23.7	32.2
Wood and Wood Products	16	42.9	76.4	20.7	2.7	178.0	27.2	48.3
Paper and Paper Products	24	149.3	141.7	47.4	6.2	95.0	33.4	31.7
Rubber	4	8.9	13.1	3.3	2.2	148.0	24.9	36.8
Leather and Leather Products	11	28.4	44.1	12.7	2.6	156.0	28.9	44.9
Chemicals	72	388.3	377.2	103.6	12.0	97.1	27.5	26.7
Capital Goods	55	245.8	431.3	85.9	4.5	175.5	19.9	34.9
Mechanical	11	39.6	49.4	11.3	3.6	125.0	22.9	28.6
Electrical	28	118.9	204.6	47.4	4.3	172.0	23.1	39.8
Transport Equipment	16	87.3	177.3	27.2	5.5	200.0	15.4	31.2
Others	15	27.8	41.4	10.3	1.8	148.9	22.0	44.1
Total	487	1,965.7	2,501.0	634.6	4.0	127.0	25.4	32.3

1/ As presented in project applications.

Source: Prepared by the Mission from raw data supplied by SUDENE.

Table 15: NORTHEAST - CHANGE IN INDUSTRIAL STRUCTURE, 1955, 1962, 1965, AND PROJECTED 1973

(GROSS VALUE ADDED)

(in NCr$ 1,000 at 1968 prices)

Industry Branch 3/	1955	1962	1965	Projected to 1973 A 1/	B 2/
Traditional	550.9	825.6	939.4	1,407.5	1,602.4
Wood	7.0	11.3	16.5	57.0	73.9
Furniture	9.6	17.5	22.2	31.6	35.5
Leather and Hides	9.3	13.2	13.2	27.1	32.9
Textiles	210.1	301.5	257.5	444.3	522.2
Clothing and Shoes	13.6	19.6	24.4	69.9	88.8
Food Products	228.7	344.0	457.3	577.1	627.0
Beverages	23.2	44.2	56.8	102.7	121.8
Tobacco	33.3	48.2	63.0	64.6	65.2
Printing and Publishing	13.8	22.0	20.3	22.5	23.4
Sundries 4/	2.3	4.1	8.2	10.7	11.7
Dynamic "A"	95.9	298.2	413.2	1,173.6	1,490.5
Non-metallic Minerals	22.7	70.8	113.9	269.7	334.6
Metal Industries	13.4	31.0	47.1	245.2	327.8
Paper and Cardboard	5.1	10.8	7.7	105.0	145.5
Rubber	5.4	9.8	6.1	12.0	14.5
Chemicals 5/	49.3	175.8	238.4	541.7	668.1
Dynamic "B"	4.0	8.0	15.9	163.3	224.8
Machinery Excluding Electrical	1.9	1.9	5.0	36.4	49.5
Electrical and Communications Equipment	0.3	1.6	7.9	81.8	112.6
Transport Equipment	1.8	4.5	3.0	45.1	62.7
Total	650.8	1,131.8	1,368.5	2,744.4	3,317.7

1/ Projection A anticipates the changes in industrial value-added and structure which may be expected to result from SUDENE-approved projects once they are in operation. It assumes: a) only a negligable contribution to 1965 value-added from SUDENE projects approved through that year; b) no contribution from existing or new industrial projects outside the SUDENE system; c) no output in 1973 from SUDENE projects approved after 1968; and d) output at 60% of capacity.

2/ Projection B also makes assumptions a, b, and c above, but assumes output at 85% of capacity.

3/ IPEA classification.

4/ Including plastics.

5/ Including pharmaceuticals and cosmetics.

Sources: 1955-IBGE, Producao Industrial Brasileira 1958; 1962-IBGE, Registro Industrial 1962, in Anuario Estatistico do Brasil 1965; 1965-A.E.B. 1967; 1973 - unofficial SUDENE projections, based on investment data and value-added to investment ratios calculated from project applications. The SUDENE projections were corrected by the mission, by netting out indirect taxes.

Table 16 : NORTHEAST - CHANGE IN INDUSTRIAL STRUCTURE, 1955, 1962, 1965, AND PROJECTED 1973

(Per Cent of Total Gross Value Added in Industry)

Industry Branch 3/	1955	1962	1965	Projected to 1973 A 1/	Projected to 1973 B 2/
Traditional	84.7	73.0	68.7	51.3	48.3
Wood	1.1	1.0	1.2	2.1	2.2
Furniture	1.5	1.5	1.6	1.2	1.1
Leather and Hides	1.4	1.2	1.0	1.0	0.9
Textiles	32.3	26.7	18.9	16.2	15.7
Clothing and Shoes	2.1	1.7	1.8	2.5	2.7
Food Products	35.1	30.4	33.4	21.0	18.9
Beverages	3.6	3.9	4.1	3.7	3.7
Tobacco	5.1	4.3	4.6	2.4	2.0
Printing and Publishing	2.1	1.9	1.5	0.8	0.7
Sundries 4/	0.4	0.4	0.6	0.4	0.4
Dynamic "A"	14.7	26.3	30.2	42.7	44.9
Non-metallic Minerals	3.4	6.3	8.3	9.8	10.1
Metal Industries	2.1	2.7	3.4	9.0	9.9
Paper and Cardboard	0.8	1.0	0.6	3.8	4.4
Rubber	0.8	0.9	0.4	0.4	0.4
Chemical 5/	7.6	15.4	17.5	19.7	20.1
Dynamic "B"	0.6	0.7	1.1	6.0	6.8
Machinery Excluding Electrical	0.3	0.2	0.3	1.3	1.5
Electrical and Communications Equipment	-	0.1	0.6	3.0	3.4
Transport Equipment	0.3	0.4	0.2	1.6	1.9
Total	100.0	100.0	100.0	100.0	100.0

Footnotes: Same as table 15.
Sources: Same as table 15.

CHART A

POINT SYSTEM FOR DETERMINING PRIORITY LEVEL AND PROPORTION OF 34/18 FUNDS

Each project is classified in a priority category according to the number of points - the more points, the higher the proportion of 34/18 funds.

OLD SYSTEM			NEW SYSTEM (As of March '69)		
Priority Class	Proportion of 34/18 funds	Number of points	Priority Class.	Proportion of 34/18 funds	Number of points
A	75%	$50 \leq P$	A	75%	$50 \leq P$
			B	60%	$40 \leq P < 50$
B	50%	$30 \leq P < 50$	C	50%	$30 \leq P < 40$
			D	40%	$25 \leq P < 30$
C	25%	$P < 30$	E	30%	$P < 25$

CRITERIA FOR ATTRIBUTING POINTS

INDUSTRIAL AND TELECOMMUNICATIONS PROJECTS

BASIC CRITERION	DETAILED CRITERION	POINTS
TYPE OF ACTIVITY	Telecommunications between distant points in SUDENE area	25
LOCATION	States of Piaui and Maranhao	20
	States of Rio Grande do Norte and Sergipe	15
	Other states, except area in and around Recife and Salvador	10
	Area in and around Recife and Salvador	5
ESSENTIALITY	Basic or "germinative" industries, which produce intermediate goods of generalized use in industry, agriculture or fishing (as determined by SUDENE)	25
	Basic food industries	20
	Projects participating in SUDENE high priority programs	10
	Pioneering industries, i.e., without similar within the state, using local raw materials and selling locally.	10
USE OF REGIONAL INPUTS	When over a given proportion of raw material and intermediate input costs correspond to raw materials and intermediate goods produced within the Northeast if 50% or over	5
IMPORT SUBSTITUTION AND CONTRIBUTION TO EXPORTS	Whenever the project substitutes imports from outside the region or promotes exports out of the region.	5
	Whenever capital equipment has a high proportion of domestic components and if foreign equipment exceeds US$ 100,000, when these do not have a domestic "similar" and are imported with adequate foreign financing or are registered as foreign investment.	5
EXPANSION/MODERNIZATION	Whenever this produces an increase in profitability.	5
NON-CONCENTRATION OF OWNERSHIP	When 34/18 deposits are supplied by at least 10 different depositors; if the 34/18 contribution exceeds 10,000 times the minimum salary, when at least 50% of this contribution comes from 25 different depositors, each representing at least 1% of the total.	5
ABSORPTION OF LABOUR	Projects which represent at least 300 stable direct jobs or in which labour costs + social charges represent over 25% of gross value added.	5

INDUSTRIAL, TELECOMMUNICATIONS AND ELECTRIC POWER

BASIC CRITERION	DETAILED CRITERION	POINTS
TYPE OF ACTIVITY	Telecommunications between distant points in SUDENE area.	25
	Rural electric power generation, transmission or distribution.	25
LOCATION	Same	25
	Same	20
	States of Ceara, Paraiba, Alagoas and Minas Gerais (within Sudene area)	15
	Sections of Pernambuco and Bahia within Draught Polygon and section of Bahia west of Draught Polygon.	10
ESSENTIALITY	Industries which produce goods "essential" to regional development, as determined by SUDENE, within the following categories:	
	Capital goods and basic intermediate goods	20
	Other intermediate goods	15
	Consumer durables and textiles	10
USE OF REGIONAL INPUTS	Same, not including "elementarily processed" raw materials and unprocessed minerals	
	if 80% or over	15
	if 50% or over, but less than 80%	10
IMPORT SUBSTITUTION AND CONTRIBUTION TO EXPORTS	Whenever theproject substitutes imports from outside the country or when at least 40% of projected sales will be exported outside the country.	10
EXPANSION/MODERNIZATION	Whenever this produces an increase in productivity (excluding firms with previous 34/18 financing)	5
NON-CONCENTRATION OF OWNERSHIP	Firms registered as "open capital" firms in the Northeast, as defined by official (Central Bank) regulations.	5
ABSORPTION OF LABOUR	Projects in which labour costs and social charges represent over 25% of gross value added	5
	Projects which "represent intensive labour absorption, without drawbacks on the adequacy of technology" expressed by direct jobs creation and (low) capital intensity. The number of points will be calculated by the formula $P = \frac{1,250}{Ds} + .025\ E$ where Ds = ratio between investment per worker and the value of the minimum salary; E = number of new direct jobs. The number of points will in any case not exceed	≤ 25
LABOUR PARTICIPATION IN PROFITS	Projects in which labour participates in taxable profits, at the rate of 10% or over	5